In the Supreme Court of the United States

October Term 1952

The Western Pacific Railroad Corporation and Alexis I. duP. Bayard, Receiver, *Petitioners*, vs. The Western Pacific Railroad Company, et al., *Respondents.*	**No. 150**
Meredith H. Metzger, Henry Offerman and J. S. Farlee & Co., Inc., *Petitioners*, vs. The Western Pacific Railroad Company, et al., *Respondents.*	**No. 160**

On Writs of Certiorari to the United States Court of Appeals for the Ninth Circuit

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Brief for Respondents

OPINIONS BELOW

The opinion of the District Court (R. 258), is reported at 85 F. Supp. 868. The Court of Appeals opinions on the merits (R. 2214, 2239) are reported at 197 F.2d 994; the opinions concerning rehearing procedures (R. 2260, 2261, 2288, 2296, 2313) are reported at 197 F.2d 1012. The supplement to the dissenting opinion of Chief Judge Denman (R. 2313) has not yet been reported.

JURISDICTION

The judgment of the Court of Appeals was entered October 29, 1951 (R. 2255). The order of that court denying the petitions for rehearing and striking them, in so far as they sought rehearing in banc, was entered January 30, 1952 (R. 2259). On July 9, 1952, six of the seven judges of the Court of Appeals concurred in denying a motion to reinstate the petitions for rehearing, Chief Judge Denman dissenting. The petitions for a writ of certiorari were filed on June 23 and June 26, 1952, and granted October 13, 1952. The jurisdiction of this Court is invoked under 28 U.S.C. Sec. 1254(1).

QUESTIONS INVOLVED

1. A holding company owned the stock of its subsidiary, an operating railroad company. That stock was determined to be valueless in a reorganization proceeding in which the holding company participated. Thereafter, in accordance with 25 years of prior practice, consolidated income tax returns were filed by the holding company for the members of the railroad group, including the trustees of the bankruptcy court. As a consequence of those returns income earned by the trustees was offset in large part by the loss of the holding company, thereby reducing the taxes otherwise payable by the trustees. Does the holding company have a claim for the taxes thus "saved"?

2. Does the failure of the holding company, a party to the reorganization proceeding, to present its "tax saving" claim to the bankruptcy court bar that claim even though it were otherwise valid?

3. Is the claim, even though otherwise valid, barred by limitations, estoppel and res judicata?

4. If the claim were valid and enforceable, what is the amount of the "tax saving" to which it relates and how would the claim for a "tax saving" payment be measured?

5. Did the Court of Appeals, having denied the petition for rehearing, err in striking the petition for rehearing in banc as "being without authority in law or in the rules or practice of this court"?

STATUTES INVOLVED

1. The consolidated returns were filed under Section 141 of the Internal Revenue Code (26 U.S.C. Sec. 141) and the provisions of Treasury Regulations 104 and 110. The stock loss deduction is authorized by Section 23(g)(4) of the Code, enacted in October, 1942.

2. The reorganization proceeding was conducted under Section 77 of the Bankruptcy Act (11 U.S.C. Sec. 205).

3. Section 46 of the Judicial Code (28 U.S.C. Sec. 46) contains provisions for hearings and rehearings in banc in the Courts of Appeals.

STATEMENT

This case brings here a claim rejected as invalid by both courts below and which, even if it were valid, could not now be allowed without nullifying the finality of a reorganization proceeding and disrupting the control of the bankruptcy court over the expense of that proceeding. The position of petitioners is without support in the precedents; it has never been approved by any disinterested person; it is radically at odds with the uniform practice of the Western Pacific group and the business community; and it is contrary to the conclusions of the Securities and Exchange Commission, the Federal Trade Commission and the Inter-

state Commerce Commission, the agencies of government most directly concerned with the regulation of holding company systems.

The circumstances of the case are related below and in greater detail than would ordinarily be appropriate for a brief here. The reason is that petitioners have briefed a case quite remote, in many fundamentals, from the case in the record. To correct, point by point, the inaccuracies and distortions appearing in petitioners' briefs would be a lengthy process of little assistance to the Court. Respondents believe that the Court can better be served by an accurate description of what the record reveals.

The facts, demonstrating that these were honest transactions honestly and openly conducted, are these:

The petitioner Corporation, a holding company, acquired all the stock of the operating railroad company in 1916, following the first Western Pacific bankruptcy (R. 493). The Corporation, as sole owner of the operating company, took charge of that company's affairs and managed the railroad from the Corporation's New York office (R. 737). That office was the head office of the system (R. 737) where policy was established and all significant decisions were made (R. 740-2). The expense of the office was divided between the Corporation and the operating company (R. 643-4).

In the fashion customary for holding company systems, the Corporation arranged for its officers to become officers of the operating concern: Thomas M. Schumacher, president of the Corporation, became the chief executive of the operating company (Ex. P. 34B,[1] R. 531, 519, 1719, 522,

[1] Trial exhibit numbers cited herein refer to exhibits which, with leave of Court, have not been printed.

1724); Michael J. Curry, the Corporation's Secretary and Treasurer, became a vice-president of the operating company (R. 519, 1719, 522, 1724, 640); and somewhat later Pierce & Greer, counsel for the Corporation in this litigation, became, on Mr. Schumacher's recommendation (R. 793), general counsel for the Corporation and counsel for the operating railroad (R. 793, 1031). Petitioners now criticize these "dualities". It must be plain, however, that the "dualities" were created by the Corporation itself for its own management purposes and, moreover, that what was done here is the accepted practice in holding company systems. Petitioners also attack the James interests. The record reveals, however, no more than this: that in 1925 Arthur Curtiss James acquired, directly or indirectly, approximately 61% of the common and 8.8% of the preferred stock of the Corporation (R. 501) and that until February, 1942, the James interests had a representative on the Corporation's Board (R. 1480, 520, 1720). Since then the James interests have had no special Board representation and nothing has been discovered to suggest that Mr. James and his associates failed in loyalty to the Corporation. Indeed, the James interests continued to support the Corporation by loaning it money long after it became apparent that in all probability the loans would never be repaid (R. 776, 1854-8).

The Corporation managed its subsidiary, the operating company, for nearly twenty years (R. 737, 740-2). In 1935 the company became unable to pay the interest on its large bonded indebtedness to the public and a second reorganization proceeding was begun (230 I.C.C. 61, 64). In October of that year trustees were appointed by the bankruptcy court

to take charge of the railroad properties (R. 1184-9, 1916, 1923). Those trustees were Sidney M. Ehrman, a San Francisco lawyer (R. 1223-4), and Thomas M. Schumacher, president of the Corporation, who became a trustee upon its recommendation (R. 1627). Charles Elsey, later to become president of the reorganized company, was managing agent for the trustees (R. 1224, 1251). The trustees operated the railroad for over nine years. The properties were returned to the reorganized company on December 31, 1944 (R. 36-108, 1711). This case relates to income received by the trustees during the period of their operation and to taxes on that income.

Under the reorganization plan formulated by the Interstate Commerce Commission (230 I.C.C. 61, 233 I.C.C. 409) and approved by this Court (*Ecker v. Western Pacific R. R. Corp.*, 318 U.S. 448) the new bonds of the reorganized company, in the total amount of $10,000,000, were issued to the Reconstruction Finance Corporation (Par. O, 233 I.C.C. 451), which had loaned money to the reorganization trustees for the purpose of rehabilitating the railroad properties. The public, holding the old first mortgage bonds, had to exchange those bonds for income bonds, preferred and common stock (Par. P(2), 233 I.C.C. 451). The stock of the old company, owned by the Corporation, was declared valueless and ordered cancelled (Par. P(7), 233 I.C.C. 452). The plan assigned certain values to the securities of the new company: par for the bonds and preferred stock and $57 to $62 per share for the common (233 I.C.C. 417). On this valuation the junior secured creditors of the old company were unpaid by $3,495,900 plus interest (R. 1220-2, 2021). With trivial exceptions, moreover, the new company securities have

never had, by a wide margin, the value the plan ascribed to them (Appendix D). Thus, whatever may be the situation in other cases, the reorganization plan in this instance was obviously no more drastic to the junior interests than circumstances required.

The Corporation, like most holding companies, depended for revenue on interest and dividends from its subsidiaries, in this instance the operating company and (to the extent of a half interest) the Denver & Rio Grande Western Railroad Company (R. 748). When both the Western Pacific and the Rio Grande properties were placed in reorganization the Corporation had little income (R. 774, 1854) and its financial situation grew critical. For a time it succeeded in paying its share of the New York office expense by borrowing from its secured creditors, including the James interests (R. 771-2, 776, 1854). When these advances stopped, the Corporation renewed its earlier suggestion (R. 771, 1839, 1845, 1852-3) that the trustees of the bankruptcy court assume a larger share of the office expense. The trustees, after consultation with the bankruptcy court (R. 1230-1) and to the knowledge and with the approval of the Corporation directors (R. 1002-3) agreed to assume and beginning June 1, 1943 did assume all the expense, including salary expense, of maintaining the New York office (R. 527, 1738). This arrangement had no relation to tax problems of the trustees (R. 1245, 1257). It was suggested by the Corporation itself and accepted by the trustees only because Mr. Schumacher, the New York trustee, needed a New York office (R. 1244-5, 1257) and because the Corporation, with no income, was desirous to stay active at least until the final result of both reorganizations was known. As a further economy measure, Mr.

Schumacher resigned as president of the Corporation (R. 743) and Mr. Curry, theretofore secretary and treasurer of the Corporation (R. 519, 1719), was selected by the Board as his successor (R. 644, 1016). Upon the resignation of Mr. Schumacher the officers of the Corporation became Mr. Curry and two office employees, Mary Valouch and J. F. Wienken (R. 519, 1719) and its directors, in addition to Mr. Schumacher and Mr. Curry, were A. Perry Osborn, Willis D. Wood, H. Brua Campbell and four employees of the New York office appointed to fill vacancies occurring during the reorganization period (R. 520, 1720).

The Corporation now complains about the character and competence of its officers and directors. It is hardly the part of respondents to defend Corporation personnel against an attack by Corporation counsel, but in the interest of fairness it should be said that there is no justification for counsel's criticism. Mr. Schumacher was a thoroughly experienced railroad executive (R. 637, 1231), characterized by petitioners themselves as a man "of great ability and great honesty of character" (R. 993). Mr. Curry, Mr. Schumacher's successor as president of the Corporation, had been for many years Mr. Schumacher's principal assistant in managing Corporation affairs (R. 736, 1135) and, according to the District Judge who heard him testify, he was "a perfectly competent man, intelligent, and probably a pretty good railroad man" (R. 785). Mr. Osborn was an experienced New York lawyer who, until his death, was of counsel for the Corporation in this case and who came to its Board at the suggestion of the Chase National Bank (R. 990). Mr. Wood was a broker (R. 1121), past governor of the New York Stock Exchange (R. 1122) and a director of many

well-known companies (R. 1122-23). Mr. Campbell was a member of the firm of Pierce & Greer, counsel for the Corporation here. For its lawyers the Corporation had in the reorganization proceeding Judge M. C. Sloss of San Francisco, a former Justice of the Supreme Court of California, a man whose competence and integrity are beyond question (R. 1600, 1603), and, as general counsel, Messrs. Pierce & Greer, who for thirty years have represented large railroad organizations (R. 1030) and who, during the period in question, were vigorously looking after the Corporation's welfare by prosecuting various claims on its behalf, including another suit against respondents (R. 1048-52). Mr. Nicodemus, the senior partner of Pierce & Greer, is sufficiently experienced in litigation to be on the Corporation's brief in this Court and he had had sufficient tax experience to be the 1943 chairman of a special tax committee organized by the railroads (R. 1034-35). The officers and directors of the Corporation and each of its lawyers all testified that they did their best on behalf of the Corporation in an independent fashion and free of any influence or control by anyone (Curry, R. 744, 747-8; Osborn, R. 1011-12, 1014-15; Wood, R. 1126; Hatton, R. 1136; Sheehan, R. 1143; Nicodemus, R. 1040, 1046; Sloss, R. 1610-11). There is not a word in the record to support a contrary conclusion.

Railroads and other large enterprises customarily file consolidated tax returns, one effect of which is that losses of one member in the holding company system offset the income of other group members. The return thus reflects the true income of the enterprise and the tax is measured accordingly. Under a consolidated return a single tax is calculated and paid for the parent and all its subsidiaries.

That tax must thereafter be allocated among the group members and the accepted and approved practice is to allocate the tax to those members of the group having taxable incomes and in proportion to those incomes. Payments such as those demanded by petitioners, that is, payment from one group member to another on account of taxes "saved" by filing a consolidated return, are not made.

Each year beginning in 1918 the petitioner Corporation filed consolidated returns for the Western Pacific group and under its direction the tax was allocated to and paid by the group members in the customary fashion and with no tax saving payments (R. 1258-9, 1262, Ex. D. 40, R. 1516-17). Each year the consolidated returns were prepared in the New York office, signed there and filed with the New York Collector of Internal Revenue (R. 1258-9, 843-4, Ex. D. 40). For fifteen years, from 1927 forward, the returns were prepared under the supervision of Mr. Curry, the Corporation treasurer (R. 844-6). Never at any time were the returns submitted to the directors for approval or discussion at Board meetings (R. 846). This identical practice continued during the period of trustee operation of the railroad properties (R. 1263). During part of that period, and particularly during the war years, the income of the trustees was large and in the absence of consolidated returns the trustees would have been required to pay a substantial tax to the United States. For reasons about to be explained, consolidated returns reduced those taxes. The first year of so-called tax saving is 1942.

The 1942 Western Pacific returns were prepared in tentative form early in 1943 in the New York office under the supervision of Mr. Curry, who signed and filed them on

March 15, 1943 (R. 821). They were consolidated returns and the 1942 losses of the Corporation were used to offset in part the income of other group members (R. 823-5, 1881-83). Shortly after these tentative returns were filed Mr. Nicodemus, counsel for the Corporation in this case, who had discussed the tentative returns with Mr. Curry (R. 697-8), suggested to Mr. Schumacher, one of the trustees, that in view of the large income received by the trustees from the railroad properties the trustees would do well to obtain expert tax advice and he suggested for that service the New York law firm of Whitman, Ransom, Coulson & Goetz (Ex. P. 39B, R. 544-5, 1079). James K. Polk of that firm had worked with consolidated returns for many years, both in and out of the Bureau of Internal Revenue (R. 1396-8). Mr. Schumacher consulted Mr. Ehrman, his co-trustee, and they decided to employ the Whitman firm (R. 543, 547, 1746, 1233).

Mr. Polk approached his task in exactly the fashion to be expected of any competent tax lawyer. His obvious responsibility was to obtain for the Western Pacific group the lowest tax consistent with the Revenue Acts. Accordingly he reviewed the tax history of the group (R. 1400), arranged for an independent tax accountant to assist in the preparation of the returns (R. 1402), computed the tax on a variety of assumptions (R. 1404, 1444-5) and recommended consolidated returns as final returns for 1942 (R. 1444). One important reason for consolidated returns was to make available the operating loss carry-overs and excess profits credits, amounting to several million dollars, accumulated by the trustees in prior years (R. 922). These carry-overs and credits could operate to reduce trustee taxes for

1942 only if consolidated returns were filed (Treas. Regs. 110, Section 33.31(e) and (f)). The 1942 returns, prepared as always in the New York office (R. 830), and signed and filed by Mr. Curry, president of the Corporation, on May 15, 1943 (R. 831, 837), reported a consolidated tax of $4,201,821.54 (Ex. P. 3 A/B, R. 490-1). With insignificant exceptions this tax resulted from the earnings of the bankruptcy court trustees (Ex. D. 40, R. 1516-17) and accordingly funds were provided from the bankruptcy estate to pay the tax (R. 824, 1306-07). The trustees allocated to the subsidiaries of the operating company, in accordance with the traditional formula, the small amount of tax owing from them (Ex. D. 40, R. 1516-17). The Corporation having no taxable income, paid no tax (R. 1552, 2040).

Shortly after the 1942 returns were filed Mr. Polk orally reviewed the tax situation with Mr. Curry, the Corporation president, and Mr. Nicodemus, Corporation counsel (R. 839, 1079-80) and immediately thereafter prepared a detailed written report dated May 20, 1943, which was addressed to Mr. Curry (R. 591, 1757) and circulated to Mr. Schumacher (R. 862) and Mr. Nicodemus (R. 862, 1884), who reviewed it together (R. 864). A copy of the report was provided to Mr. Elsey in San Francisco (R. 1266). The report suggested, among other things, that it was possible that under a then recent amendment to Section 23(g) of the Internal Revenue Code the loss of the Corporation, upon a determination that its stock in the operating company was worthless, would constitute a consolidated return offset to income of other group members (R. 591, 1757).

During the fall of 1943 the courts approved the reorganization plan and thus there was a final determination that

the Corporation's stock in the operating company was worthless. The loss of the Corporation's investment in the operating company, calculated for tax purposes at $73,-478,023.04, greatly exceeded group income for 1943 (Exs. P. 4A/B, R. 491, Ex. D. 40, R. 1517). As an economic matter that loss had occurred over the years as the operating company became increasingly insolvent. As a tax matter, however, the loss was realized when the order confirming the reorganization plan became final in November 1943 (Ex. P. 54, R. 605-10, 1409-10). It was therefore a 1943 loss.

Consolidated returns for 1943 reporting the loss of the Corporation as an offset to group income were prepared as in all prior years in the Corporation's New York office (R. 1414), signed by Mr. Curry (R. 664) and filed by him on July 15, 1944 (Exs. P. 4A/B, R. 491). Mr. Curry had been consulted from time to time in connection with the preparation of the returns (R. 1415) and he knew that the Corporation's loss was taken as a deduction (R. 682, 702-4). The returns reported no tax owing (Exs. P. 4A/B, R. 491).

Some months earlier the reorganization trustees, recognizing the uncertainties in the 1943 tax situation, had asked the bankruptcy court for leave to establish a reserve for taxes (R. 619, 1772). A hearing was held (R. 1270-4); the tax situation was reviewed (R. 1267, 2023, 1270-4); and an order was entered approving a reserve of $7,100,000 for tax purposes (R. 1086, 1895). Judge Sloss and Mr. Nicodemus, attorneys for the Corporation, received notice of the hearing and copies of the order of the court (R. 1991, 1217).

Under the provisions of the Internal Revenue Code (Sec. 122(b)) the 1943 loss of the Corporation could be carried backward and forward to offset group income for earlier

and later periods. Accordingly, a claim for refund of the 1942 taxes paid by the trustees was prepared by Mr. Polk as a routine matter (R. 1450), signed by Mr. Curry (R. 667), and filed in ordinary course on March 9, 1945 (R. 492, 1654). The 1944 returns reporting no tax owing (Exs. P. 5A/B, R. 492) were signed and filed by Mr. Curry (R. 666) on June 15, 1945 (Exs. P. 5A/B, R. 492). The effect, however, of the Corporation's loss on group taxes did not extend beyond the first four months of 1944. For on May 1st of that year, with the approval of the bankruptcy court (R. 1192, 1930), the stock of the operating company owned by the Corporation was transferred to the reorganization committee for cancellation (R. 493). This terminated the affiliation between the Corporation and the other group members and thus the possibility of filing consolidated returns for a subsequent period was eliminated.

After the returns for 1942 and 1943 and the 1942 refund claim had been filed but before the 1944 returns were completed, the New York office of the Corporation was closed (R. 650A, 891). This left Mr. Curry, who had been with the Western Pacific group for more than twenty years, without a satisfactory source of income (R. 1017, 1110, 1496). Conversations on his behalf were held by Mr. Nicodemus and Mr. Osborn with Mr. Coulson of the Whitman firm (R. 1017, 1110) and arrangements were eventually made to provide Mr. Curry with quarters in the Whitman offices in New York (R. 651). Mr. Curry also received a small retainer to stand by to assist in tax matters if, upon the audit of the returns, his services were required (Ex. P. 33, R. 529). The Corporation directors were familiar with this arrangement (R. 899, 901-3, 1017) and Mr. Curry's

testimony made it clear that during the period his office and files were in the Whitman suite he was quite free to take any action he though advisable in the Corporation's interest (R. 904).

In view of the large amounts involved, it was inevitable that the Bureau would carefully audit the Western Pacific returns. That audit took place during 1946 and 1947 and Mr. Polk, holding powers of attorney from all group members, including both the Corporation and the company (R. 626, 1784, R. 1441), represented the group in that connection. Correspondence (R. 626, 1779) and conferences between Mr. Polk and Bureau representatives (R. 1418-20, 1423-31) culminated in a proposal that the United States accept the returns as filed and deny the refund claim designed to recover the 1942 tax (R. 2142). This meant, in effect, that the tax liability for the entire period of two years and four months would be discharged by the payment of $4,201,821.54. Mr. Polk, with the approval of the reorganized company (R. 683, 1801) which was responsible for the taxes of the trustees (R. 499, 1711), submitted this proposal to the Bureau on February 11, 1947 (R. 2142). On April 2, 1947, he advised the Corporation in detail (R. 669, 1788). In the meantime and on October 1, 1946 this litigation had begun (R. 5). After a good deal of negotiating and following a stipulation in this proceeding recognizing that the tax moneys received by the United States were intended to apply pro rata over the entire period involved (R. 493, 1658), the directors of the Corporation by formal action approved the settlement proposal (R. 1103, 1644-5). On August 13, 1947 the proposed settlement was accepted by the Bureau (R. 492, 1664-5).

Petitioners complain that the Corporation was uninformed as to these tax transactions. The record contains overwhelming evidence to the contrary. The consolidated returns were prepared in the Corporation's office (R. 829-30, 844-6, 1258-9, 1414) as long as the office was open (R. 891, 1287) and were signed and filed by its president (R. 663-66, 831, 837). The Corporation had, therefore, an immediate and unimpeachable source of information as to the nature and content of those returns. In addition, the Corporation had, among other things, Mr. Polk's oral report on tax matters to Mr. Curry and Mr. Nicodemus on May 18, 1943 (R. 839, 1079-80), Mr. Polk's letter of May 20, 1943 (R. 588, 1757) reviewing the tax situation in detail, the annual reports of the trustees which discussed tax problems (Exs. P. 20-B, 20-C, R. 511-14, 1279) and the order of the bankruptcy court establishing a tax reserve (R. 1216, 1991, 703, 1085). Mr. Curry, the Corporation president, had handled tax matters for the Western Pacific group for many years (R. 841-45). He fully appreciated the difference between consolidated and separate returns (R. 1637, 2087-90) and he thoroughly understood the effect of these particular returns, as evidenced by the fact that he wrote to Mr. Nicodemus explaining them (R. 705, 2125). Mr. Schumacher was familiar with the tax transactions throughout (R. 876-77); Mr. Osborn, another director, knew that consolidated returns resulting in substantial benefits to the trustees were being filed (R. 1019-22); Mr. Wood did not doubt that consolidated returns would be used (R. 1132-3). Since the Corporation would pay no tax in any event (R. 1551, 2040), it had no financial interest in tax matters but, nevertheless, the returns could not be filed except as they were signed and

filed by the Corporation (Treas. Regs. 104, Sec. 23.16). The trustees, who would have had to pay any tax the Government collected, quite naturally hired and paid tax counsel (R. 543, 1746, 1233). But Mr. Polk only gave advice (R. 1403, 1414, 1415, 1417). He did not make decisions. The effective decisions were necessarily made by the Corporation itself when it filed the returns and when by formal action of its Board and after this litigation was under way it approved the settlement.

Nor did the Corporation suffer from a lack of resourceful legal representation. The possibility of a "tax saving" claim on behalf of the Corporation occurred to Mr. Nicodemus, its counsel, and he discussed that possibility with three prominent tax lawyers: Thomas Tarleau, then recently legislative counsel for the Treasury (R. 1059), Leslie Rapp, formerly minority clerk of the House Ways and Means Committee (R. 1059-60) and Claude Dudley, who was associated with Mr. Nicodemus in his efforts to obtain favorable tax legislation from Congress (R. 1063). Mr. Dudley, like Mr. Polk (R. 1433), Mr. Elsey (R. 1285), Mr. Ehrman (R. 1240-42) and the prominent tax specialists who offered to testify on the call of respondents (R. 1586-95), had never heard of any such claim (R. 1063). Mr. Tarleau and Mr. Rapp thought the idea had no merit (R. 1062-63). On this advice and until this litigation Mr. Nicodemus did not pursue the suggestion further. But obviously the Corporation did not suffer from lack of information or ingenuity.

On December 31, 1944 the railroad properties were returned, by order of the bankruptcy court, to the reorganized company (R. 36, 498, 1711). At that time all duality ceased. Those of the Corporation's directors and officers who had

It has ruled that for the purpose of determining earnings and profits available for dividends a company which joins in a consolidated return is to be charged only with its pro rata of the tax and without tax saving payments. Moreover, a holding company which offsets its income by a subsidiary's loss must reduce the basis upon which it holds the stock of the subsidiary by an equal amount, a manifest injustice if it were contemplated that the holding company would pay for the tax saving.

The reasons for this unanimous disapproval of petitioner's position are not far to seek. Consolidated returns are authorized by Congress because, as an administrative matter, they free the government from the necessity of allocating and reallocating profit and loss among the group members and because, as a matter of fairness, they permit a business organized by subsidiaries to pay no more tax than a business organized by departments where the losses of one department freely offset the profits of another. The taxpayers under the consolidated returns remain, nevertheless, the individual companies and the effect of the return, concisely stated, is only that the tax of each is calculated to some extent by the financial transactions of all the others. No one has been able to see why on that account the companies joining in the return have claims against each other.

The argument for compensation for the "use of the loss" proves on examination to be based entirely on loose definition and inexact analysis. The loss, since it has tax consequence, is said to be "property," an "asset" of the loss company. This is casuistry. A loss is not an asset but the lack of assets, not property but no-property. In a consoli-

dated return the loss has tax consequence—but is still a loss and nothing more. And even this is not precisely accurate. Fundamentally the tax law operates on business transactions, events in the world of affairs. A company operates its plant and sells its product at a net loss in the taxable year of $100,000. This fact entered in a separate return means that it pays no tax. Entered in a consolidated return this fact may mean that neither the company itself nor its affiliate pays a tax. But the first company on that account has no claim on the second. It has manufactured its product as best it knew how and sold that product at the best price it could obtain. This activity, undertaken purely on its own account and for its own purposes, has as a side effect, so to speak, tax consequences for the second concern. But this incidental effect does not create a claim. The loss company has done nothing for its affiliate — provided no property or service, taken no action of any kind. The most that can be said is that its misfortune has resulted, because Congress has said so, in another's gain. But this is not enough for a cause of action.

Nor can a cause of action be predicated on an assumed power to bargain. A consolidated return can be filed only if all the members of the group join in the return. Hence, if one can bargain, all can bargain; and the net result of bargaining would be only to reward the most obstinate. Affiliated companies, as this Court has so often said, must deal decently with each other. Their claims inter se are measured by justice and the law—not by power and hard trading. A loss company in an affiliated group provides no asset and no service in bringing about the tax saving. It has, therefore, no claim. And every disinterested person has said so.

There are other reasons why no one agrees with petitioners. To accept their position would be to engraft upon an already elaborate tax system an equally elaborate system of tax saving payments. Husbands and wives sign joint returns; businessmen arrange their affairs with an eye to the tax consequence; a lawyer sends a bill to make a deduction available to his client in the current accounting period. Thus far no one has supposed that the consequence is a right to compensation. If, however, the ideas of petitioners are to be accepted, there must in all such cases be agreement on a tax saving payment or a suit such as this one. And all for nothing. Whatever the immediate gain to these petitioners, the net benefit from any such practice to any particular person, over the years, is speculative indeed. What is certain is confusion and needless complexity.

Petitioners argue that the tax law intends that the parent company shall have the saving from consolidated returns. But the Revenue Acts, as everyone knows, create no private rights and even if they did there is not a word in the Code to indicate that Congress, generally hostile to holding companies, had any such intent as petitioners ascribe to it.

2. *The merits of the claim: the circumstances of this case.* There is no reason why the general rule should not apply in this case. The decision of this Court in March, 1943, approving the reorganization plan, is said to have "severed the economic unity" between the Corporation and the other group members, thereby creating a special situation. To describe the action of this Court as a "severance of economic unity" is dramatic, perhaps, but misleading. In sober truth the decision did this and no more: it made it clear that at an indefinite date not far in the future the

Corporation would be required to surrender its stock in the operating company for cancellation, which in turn made it unlikely that the Corporation would receive any benefit from the tax saving from the consolidated returns. Or, to say it shortly, it became plain that the group affiliation was about to end. But is this a reason to compel respondent to make a $17,000,000 tax-saving payment to the Corporation? For 25 years the Western Pacific group under Corporation management had filed consolidated returns, often to the Corporation's advantage, with no tax saving payments. Why, because the end of the affiliation comes in sight, is the Corporation justified in reversing its settled practice by demanding a payment the like of which had never before been made?

The fact that otherwise the Corporation would receive no benefit from the tax saving is not an argument for petitioners. The Corporation is not and was not entitled to a benefit. Aside from the formality of preparing and signing the consolidated returns it did nothing to bring about the tax saving to the trustees. That saving resulted directly from the decision of this Court and the bankruptcy court declaring worthless the Corporation's stock in the operating company. In acquiring that stock nearly 30 years earlier the Corporation was plainly acting for its own purposes and with no thought of providing a tax advantage to the trustees. In declaring the stock worthless this Court and the court below were equally unconcerned with trustee taxes. Moreover, the Corporation vigorously opposed the declaration of worthlessness. In a very real sense, therefore, the tax saving came about not because of but in spite of the Corporation.

been on the debtor's Board of Directors withdrew (R. 2109). The New York office was shortly thereafter closed (R. 1287) and thenceforth none of the Corporation's directors or officers held any position with the reorganized company (R. 1719-20, 1724, 2109, 519-21). The majority of the Board of the reorganized company were western men of affairs, who had not theretofore been directors, and who have never held any office in the Corporation (R. 1720, 2109, 519). Charles Elsey, who became president of the reorganized company, had never held a Corporation office (R. 1251). Prior to revestment Mr. Elsey arranged with Mr. Nicodemus for the termination of the latter's relations as counsel, except for some small traffic matters (R. 1047-8).

In April, 1945 the trustees filed their final account (R. 1203, 1944) and on May 21, 1945 received their discharge (R. 1203, 1986). The reorganization proceeding was closed by a final decree dated March 28, 1946 (R. 1219, 2013).

Beginning on December 11, 1939, and at all times thereafter, the petitioner Corporation was a party to the reorganization proceeding (R. 1217, 1994, 1600-3). The Corporation did not suggest, however, that it had a claim against the trustees on account of tax savings—and this even though the last of the tax returns was filed July 15, 1945 (Ex. P. 5A/B, R. 492), nine months before the reorganization proceeding closed on March 28, 1946 (R. 1219, 2013). An important reason, expressly stated, why the reorganization proceeding remained open after the properties were returned to the reorganized company was to permit the bankruptcy court to hear and consider claims against its trustees (R. 62). Nevertheless the tax saving claim was never asserted either by the petitioner Corporation or by the peti-

tioner stockholders who acquired their interest in the Corporation from two to four years before the proceeding was closed (Int. Brief, p. 3).

The complaint in this action was placed on file October 10, 1946 (R. 5, 11), five months after the final decree of the bankruptcy court. As a practical matter, however, the litigation began when the petitioner stockholders acquired a small portion of the preferred stock of the Corporation at a nominal cost[2] and in June, 1946, brought a stockholders' suit in New York against the officers of the Corporation (R. 147) charging, among other things, failure to protect the interests of the Corporation in connection with the consolidated returns. Three months later this action was filed (R. 5) and in due course the stockholders intervened (R. 121-55).

The District Court, following elaborate discovery proceedings and an extensive trial, gave judgment for respondents (R. 258, 320). The District Judge believed that the tax result was unjustified (R. 260-270) but concluded that the failure, if any, to pay taxes owing to the United States could not be corrected by awarding the tax moneys to the Corporation (R. 270-1), that the Corporation's claim as a substantive matter was without merit (R. 271-2, 274) and that it was in any event foreclosed by the failure to present it to the bankruptcy court (R. 272-5). On appeal the judgment for respondents was affirmed (R. 2214). The Court of Appeals reviewed the history of the transaction (R. 2214-18,

[2]Respondents offered to prove that the intervenors bought their $100 par value preferred stock in the Corporation in 1942 and thereafter at a total cost of $37,007.39 or an average of $1.00 per share (Exs. D. 18 id., 19 id., 59 id., R. 1146, 1642-3, 1905-07, 2102). The evidence was excluded as irrelevant (R. 1175, 1643).

2224-6), joined in the conclusion of the District Court that from first to last the tax transactions were conducted in the ordinary course of business without fraud, suppression or wrongdoing (R. 2219, 2226, 2234, 2235), noted that under the circumstances a failure by the common officers of the Corporation and its subsidiaries to file consolidated returns, thereby incurring unnecessary taxes, would have been unjustified (R. 2232-4), and determined that the Corporation, with fiduciary duties to the unpaid creditors of its subsidiary (R. 2234-5), had no claim to all or any part of moneys which in the absence of the consolidated returns would have been paid to the United States. The Honorable James Alger Fee, the United States District Judge for Oregon, sitting on special assignment in the Court of Appeals, dissented. The dissenting opinion argues that the opinion below, adopted by the District Court as its findings, was inadequate for that purpose (R. 2239). To the extent that the dissent considers the merits of the case, it tends to assume rather than argue the point at issue by assuming that the Corporation "had a property right to file or refuse to file consolidated returns" for the surrender of which it might have a claim (R. 2242).

Petitions for rehearing and for rehearing in banc were filed with the Court of Appeals. The application for rehearing was denied (R. 2259-60). The petition for rehearing in banc was stricken as being unauthorized by law or by the rules of court (R. 2260). A petition to file a motion to reinstate the petition for rehearing in banc (R. 2267) was denied by six of the seven Circuit Judges, Judge Denman dissenting (R. 2288, 2313). Application was made to this

Court for certiorari and on October 13, 1952 the certiorari petitions were granted.[3]

This detailed account of the circumstances of the case must surely demonstrate the validity of the conclusion of the courts below: that these tax transactions were in every respect open, candid and honest, free from any taint of subterfuge, improper purpose or wrongdoing (R. 970, 2219, 2226, 2234, 2235). It must demonstrate, too, that the charges which the petitioners fling so freely into this case are untrue. Petitioners would have the Court believe that the trustees of the bankruptcy court, or their representatives, seized upon the crippled Corporation, craftily kept it alive, and then by devious dealing suppressed its claims and manipulated its affairs to their own advantage. Nothing could be further from the truth. No witness so testified; no document was produced to support any such claim. The record from beginning to end is a record of honest and capable men conducting their affairs openly and in the ordinary course of business. The dualities now found invidious were in fact created by the Corporation itself for its own purposes (R. 735, 992, 1627), the same purposes of management which result in the same dualities in every holding company system. The arrangement by which the operating

[3]The courts below, both believing that as a matter of substance the Corporation's claim was without merit, had no occasion to consider all the problems presented by the litigation. The District Court accepted respondents' argument that the reorganization put an end to the claim but the majority judges of the Court of Appeals did not reach this issue. Neither court reached the defenses offered by respondents of limitations, estoppel and res judicata. Neither court had occasion, moreover, to determine the amount of the tax saving, a difficult question on which the testimony is conflicting, and neither court, of course, made any effort to define the amount of the Corporation's claim, assuming it had one, a point upon which petitioners themselves are in disagreement.

company paid part of the expense of the Corporation's New York office, now alleged to be a device for controlling the Corporation and its affairs, was as old as the affiliation itself (R. 644); and when the trustees undertook to pay all the New York expense, they did so only because the Corporation, finding itself without funds (R. 789-90, 1243-4), repeatedly requested that this arrangement be made (R. 790, 1244, 1257). The alleged capture of the Corporation's president by the Whitman firm proves to have been an arrangement made with the approval of the Corporation's directors (R. 899-903, 1017, 1495) and motivated by an attempt to provide financial security during a difficult period for a man who had rendered twenty years of exemplary service to the Western Pacific group (R. 1017, 1496). The consolidated tax returns, said to be the end product of a dark plan deviously executed, were in fact prepared in the Corporation's own offices in the identical fashion and by the same personnel who had been preparing similar consolidated returns for the Western Pacific group for many years (R. 841, 843-7). They were signed and filed by the Corporation's president (R. 846-7), a man now said to be incompetent in tax matters, but who had managed Western Pacific taxes for nearly twenty years (R. 845) and who wrote a letter about these very returns to Corporation counsel, describing them with a ludicity which would have done credit to anyone (R. 705, 2125). Mr. Polk, the tax lawyer, is harshly criticized, but on inquiry from the court petitioners found themselves obliged to concede that the tax returns were in fact properly prepared (R. 834-5), properly filed (R. 834-5), and that Mr. Polk handled tax matters for the group to the complete satisfaction of everyone (R. 1422-3). Finally,

in spite of all the intimations of suppression of the Corporation and its rights, the record shows without contradiction that counsel for the Corporation considered the possibility of a tax saving claim (R. 1060), took advice of those best qualified to advise him and decided against it (R. 1059-64). Small wonder that on this record not one of the judges below has been willing to give a moment of credence to the charges which petitioners now bring to this Court. If it is true, as petitioners apparently believe it to be true, that they can succeed only by proving that the Corporation was somehow manipulated and managed, its rights suppressed and its people beguiled and abused, consideration of this case can stop now. For both courts below in explicit fashion and on an overwhelming record have found against these contentions. The Court of Appeals, quoting the trial court, said:

"It hardly seems conceivable that Corporation could complain because consolidated returns were filed. Not only was it in accordance with past practice of the group and under the supervision of Corporation's president, as in former years, but it was done under the guidance of the independent tax experts employed upon the suggestion of the General Counsel for Corporation, who represents appellants in the present proceeding. As the trial court stated '* * * when everybody was, as they were in this case, acting completely in the open in the matter, nobody was concealing anything from anyone else, the element of fraud or deception, of the kind that you refer to, is absent * * * Everybody knew that consolidated returns were being filed * * * Everybody knew that these attorneys were being employed to file this consolidated return. It was all done right out in the open.' " (R. 2226)

But this failure to prove wrongdoing is only half the difficulty with petitioners' case. Beneath the problem of the conduct of the parties are more fundamental problems. Does the use of a loss in a consolidated return create a right to compensation? If it does not, petitioners have no claim, whatever the conduct of the parties may have been. Did the Corporation under the circumstances have a right to bargain against the trustees? If it did not, the identity of the Corporation representatives is immaterial. It is to these fundamental questions that the balance of this brief is devoted and respondents believe that the answers are plain. The Corporation does not now have and it never had any basis for a claim to compensation because of the tax transactions. The Corporation does not now have and it never had a position from which it could bargain against the trustees.

Petitioners seek to obscure their failure to establish a claim by arguing that the court trustees had fiduciary obligations to the Corporation which they failed to discharge. But a cestui, even the cestui of an express trust, cannot sue his trustee unless there has been a violation of the cestui's rights. Here, the Corporation has no claim on account of the tax transactions and it does not acquire one by proclaiming itself a cestui and the court trustees, trustees on its behalf.

The fact is, moreover, that neither the respondent nor the trustees had trust obligations to the Corporation. Prior to January 1, 1945, the respondent, the reorganized company, did not exist and the old company with its assets in the hands of the court was completely inactive.[4] The

[4]Petitioners use the term "respondent" as descriptive of three distinct entities: *first*, the pre-reorganization railroad company,

duties of the trustees of the bankruptcy court are defined by bankruptcy law and they do not include special and overriding obligations to the Corporation. Furthermore, the foundation of the Corporation's claim to a special position, the contention that it was dominated and controlled by the trustees, is completely unproved. Neither court below could be persuaded to counsel's position and the Corporation itself in answering the complaint in intervention categorically denied all charges of domination or control (R. 156). The truth is plain enough: the consolidated returns were filed not because the trustees took charge of the Corporation and its affairs but because for twenty years the Western Pacific group had filed such returns and because everyone, including the Corporation and its representatives, could see that consolidated returns produced the best tax result. The consolidated returns were the product of good sense, not the product of trustee domination of the Corporation or suppression of its rights.

But even if the trustees had controlled the tax transactions, nothing for which the Corporation contends would follow. Counsel for the Corporation have agreed that the returns were properly prepared (R. 834-5) and properly filed (R. 834-5, 1422-3). It must be obvious, moreover, that if consolidated returns had not been filed this case could not exist. Under these circumstances, with proper returns properly filed and this claim dependent upon them, what difference can it make who had charge of the work? To

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which was the Corporation's subsidiary and the debtor in reorganization; *second*, the reorganization trustees who were the court's agents in operating the railroad; and *third*, the reorganized railroad company, which was the defendant below and is the respondent here. The indiscriminate use of the term "respondent" by petitioners can serve only to mislead and confuse.

succeed here the Corporation must show that by reason of the consolidated returns it has a valid claim to the taxes saved. The Corporation has in fact no such claim and it was never in a position to bargain for a payment to which it was not entitled. It makes no difference, therefore, who had charge of the tax transactions.

The petitioner stockholders also argue that the trustees had fiduciary obligations to the Corporation. But, unlike the Corporation, they impose those duties not because of control but because of dualities; they measure them not by the rules appropriate to express trusts but by an alleged obligation to deal fairly; and, as a consequence of the alleged breach of these fiduciary obligations, they claim not $17,000,000 but some amount they are unwilling to name. The arguments of the petitioner stockholders, like those of the petitioner Corporation, fail, however, to reach the question for decision. It is suggested that in consolidated return matters the arrangement between the group members must be such as would commend itself to independent boards of directors. This suggestion is not helpful, first, because by definition consolidated returns can exist only in the presence of affiliation, and, second, because this test or the test of "fairness" is largely meaningless, as petitioners themselves demonstrate by their inability to translate it into dollars. Fairness, it seems obvious, requires a payment only if the law recognizes a claim. Again, therefore, the problem returns: did the Corporation on account of these tax returns have a claim to compensation? The answer is "no."

SUMMARY OF THE ARGUMENT

1. *The merits of the claim: the general rule.* This case has to do with consolidated tax returns and the narrow question of the rights among themselves of taxpayers who file them. The problem reaches this Court after thousands of such returns have been filed over a period of 30 years and after the issue presented here has long since been considered settled. Only once before has there been a challenge to the accepted procedure whereby the consolidated tax is allocated pro rata among the income members of the group without tax saving payments to the loss members. Insull and Hopson and a few others once adopted a practice similar to that now advocated by petitioners. They compelled subsidiaries of the holding company system to pay the parent company "taxes" calculated as though the subsidiaries were to file a separate return, whereupon the holding company filed a consolidated return and took to itself the saving. The Federal Trade Commission, studying holding companies and their procedures, noted and condemned this practice; the Committees of Congress, formulating the Public Utility Holding Company Act of 1935, echoed this condemnation; and the Securities and Exchange Commission by its Rule U-45(b)(6) has put a stop to it in the utility field. The Interstate Commerce Commission, which is also concerned with the regulation of holding company systems, has had no occasion to issue a formal order, but on more than one occasion it has refused to recognize tax saving claims and, as respondents offered to prove, the uniform practice of the railroads under Commission supervision is in accordance with the general practice and with what was done here. The Treasury plans its tax procedures on the same basis.

profits taxes of the individual companies based upon separate returns. * * *"[7] (Emphasis supplied.)

Petitioners cite and rely upon three instances in which the Commission is said to have permitted deviations from this formula. In Release No. 4444, 13 S.E.C. 649, dated July 28, 1943, "In the Matter of Consolidated Electric Gas Company, The Islands Gas & Electric Company," Islands, a subsidiary in the Consolidated group, had large war losses in Manila, which were available as tax deductions for the group. If, however, Islands reacquired its properties it would be required to pay the tax which the deductions had eliminated (I.R.C. Sec. 127(c)). The group members proposed a special arrangement to protect Islands against this tax if it were later assessed. The Commission agreed. The purpose of the arrangement was to make certain that Islands did not pay more tax by joining in the consolidated return than it would have paid on a separate return basis. This principle is of no value to petitioners. The Corporation paid no tax under the consolidated returns and would have paid no tax on a separate return basis (R. 824, 826, 1306-07).

This same purpose to protect a subsidiary from an actual loss through paying extra taxes on account of a consolidated return underlies the ruling of the Commission in Release No. 5535, 17 S.E.C. 839, dated January 3, 1945, "In the Matter of Cities Service Company." There a subsidiary was amortizing the cost of a plant at a special war-time rate which would result in complete amortization in five years. This provided the subsidiary with large deductions

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[7]For a detailed discussion as to the effect of the Rule by the National Association of Railroad and Utilities Commissioners, see Appendix B, p. 17.

from taxable income which were useful to the group in consolidated returns. It also meant that after the five-year period the subsidiary would have no amortization deduction. The group members accordingly agreed to compensate the subsidiary for the disadvantage to it arising from the tax procedures adopted.

The basis for decision in Release No. 4806, 15 S.E.C. 161, 164, dated January 3, 1944, "In the Matter of Consolidated Electric & Gas Company" is stated by the Commission as follows:

> "Inasmuch as Consolidated owns 100% of the common stock equity of each of its subsidiaries affected by the proposal, and there do not appear to be impairments in the earned surplus accounts of such subsidiaries, it is, apart from the accounting consequences of the transaction, immaterial whether the proposed payments are made in the manner proposed or the books of the subsidiaries are permitted to reflect the taxes as reduced by the subject savings and corresponding amounts paid to Consolidated by way of dividends."

Since the parent who received the payment was entitled to the money in any event, the Commission saw this case only as an accounting problem and agreed to the proposed arrangement for that reason.[8]

In none of these releases did the Commission recognize the existence of a right to a "tax saving" payment. Indeed,

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[8]Subsequent to the releases upon which petitioners rely the Commission issued its Accounting Release No. 53, wherein it gave further attention to "Charges in Lieu of Taxes," criticizing petitioners' position from the point of view of sound accounting. See Appendix B, p. 10.

Petitioners make much of an alleged power of choice residing in the Corporation, saying that the Corporation was free to file separate returns and that it therefore must be paid for its decision to file the consolidated returns, the formality which was requisite in order that the loss from the worthlessness of the stock might offset trustee income. But the Corporation had in fact no freedom of choice. It is true that the consolidated returns for 1943 and 1944 were filed after the group affiliation had terminated. But, for at least two reasons, this did not put the Corporation in a position to bargain for a payment to which it was not otherwise entitled. First, the returns related to the period of affiliation and were possible only because of that affiliation. With respect to those returns, therefore, the group members were all bound by the obligations appropriate to the affiliation period, including an obligation on the Corporation as parent to exercise its management powers in the best interest of the group and in that connection to file tax returns resulting in the minimum permissible tax payment. Payment of unnecessary taxes is no more compatible with sound management than any other waste of corporate assets. During the affiliation period, the Corporation plainly could not have bargained against its subsidiaries by threatening, in breach of its good management duty, to compel them to pay avoidable taxes. With respect to tax returns relating to the affiliation period the situation was not changed in one degree by the termination of affiliation. For it is well settled that fiduciary obligations, including the obligation of a holding company to its subsidiaries and their creditors, extend without interruption to all matters necessary to wind up the affairs of the fiduciary period.

The bankruptcy proceeding provides a second reason why the Corporation could not bargain with the group as a stranger. The operating company, unable to meet its obligations to its creditors, filed its reorganization petition at the command of the Corporation and the Corporation became a party to the proceeding, asserting there its claims against the estate. Under these circumstances the Corporation was plainly obligated to cooperate in such formalities, including the filing of tax returns, as would best protect the assets of the estate by minimizing tax payments by the trustees. This required consolidated returns not only because in such returns group losses would offset trustee income but also because only through consolidated returns would the operating loss carry-overs and unused excess profits tax credits accumulated by the trustees in earlier years operate to reduce trustee taxes. Consolidated returns could not in any conceivable fashion disadvantage the Corporation; and since the advantage of such returns to the estate was plain, the Corporation was obligated to file them, and having that obligation it could not set a price on cooperation. For in a reorganization proceeding, as this Court has been emphatic to say, the stockholders of the debtor have no strategic position, no power to bargain. "Threats by stockholders of the kind here in question are merely threats to the jurisdiction of the court, which jurisdiction these selfsame stockholders invoked for their benefit when they caused the debtor's petition to be filed. Consequently, these claims of the stockholders are, as we have said, entitled to no more dignity than any claim based upon sheer nuisance value." *Case v. Los Angeles Products Co.*, 308 U.S. 106, 130-1. The Corporation, as parent of the group and

stockholder of the debtor, could not assert a strategic position and by threatening to file separate returns drive a bargain for a payment to which it was not otherwise entitled. It was entitled to no payment on account of the tax saving because it had done nothing to bring that saving about. The tax saving resulted from a decision of the courts approving the reorganization plan—not from any property or service provided by the Corporation to the trustees.

Petitioners invoke many rules of law but make a case under none of them. Indeed, the bare fundamentals of any cause of action, proof of wrong and proof of damage, are not made out. The reference in the consolidated returns to the Corporation's loss did not wrong the Corporation and the Corporation on that account has suffered no damage. It paid no taxes under the consolidated returns as it would have paid none under separate returns. The Corporation has no unjust enrichment claim. It has been deprived of nothing; there is nothing to restore to it; and there is no ground of fraud, mistake or duress to justify an order of restitution.

The Corporation has no claim on quantum meruit. It did nothing to bring about the tax result except sign the returns, a service which, if it be one, it was plainly obligated to perform for reasons of good management and to conserve the bankruptcy estate. It transferred no property to the trustees; it never in a single particular shifted the course of its affairs to advantage the trustees. It has nothing, therefore, on which to base a claim. Discussion of dualities and fiduciary duties does not assist petitioners. This is not a case of corporate officers working for several companies

and being neglectful of the rights of one of them. The Corporation received nothing here; not because of divided loyalties, but because it was entitled to nothing.

Finally, the Corporation's position is truly without equity. The junior secured creditors of the operating company went unpaid in the reorganization proceeding by several million dollars and all the creditors, junior and senior alike, received their new securities on a valuation which the market has consistently refused to confirm. To these creditors of its subsidiary, the present stockholders of the reorganized company, the Corporation owed fiduciary duties. It now proposes to violate that fiduciary obligation by depleting the assets of the reorganized company by $17,000,000 and to that extent increasing the distance by which they go unpaid. That position has not commended itself to the courts below and it will not commend itself to this Court.

3. *The bar of the reorganization.* During 1942, 1943 and the first four months of 1944, the period in which taxes were saved, the railroad properties were operated by trustees of the bankruptcy court. If taxes were owing or saved for those years they were owing or saved by the trustees; and the taxes themselves or any valid claim on account of tax saving would have been an expense of administration. The Corporation, a party to the reorganization proceeding, failed to present its tax saving claim in that proceeding even though the bankruptcy court carefully retained jurisdiction until March 28, 1946, well after the returns were filed, to hear all such claims. This means that even if the claim were valid it could not now be allowed. There are two reasons. A claim against trustees administering properties on behalf of a court is in effect a claim against the estate and to have

validity it must receive, one way or another, the approval of the court in charge of the estate. This claim received no such approval; the estate no longer exists; the proceeding which gave rise to the estate is closed. The claim is dead.

The Corporation's claim is barred, moreover, by the finality which attaches to a reorganization proceeding. The principal purpose of such a proceeding is to so define and limit the obligations of the reorganized company that its financial position will be secure. All claims not allowed are foreclosed. This rule applies as forcibly to claims arising during the period of administration as to claims of an earlier date. The reorganization of the Western Pacific plainly fails if, with the bonded indebtedness of the reorganized company carefully limited to $10,000,000, the Corporation, a party to that reorganization, can now enforce an undisclosed claim for $17,000,000.

The assumption agreement requiring the reorganized company to discharge certain obligations of the trustees does not provide the Corporation with an escape from the bar of the reorganization. It is the practice in reorganizations to return the properties to the reorganized company before the proceeding is closed and while the court retains jurisdiction to hear claims against its trustees. After revestment, however, the court has no assets from which to pay such claims. Accordingly, it is customary to require the reorganized company to discharge them. The claims to be discharged, however, are those and only those which could be asserted effectively against the trustees, that is, claims presented to and allowed by the bankruptcy court. No one has ever supposed that this conventional method of providing credit to the court can be read to nullify the control

of the bankruptcy court over the expense of the reorganization proceeding. Nor is there any force in the suggestion that the Corporation's claim arose subsequent to the reorganization and is therefore outside the jurisdiction of the bankruptcy court. Petitioners base their demands on events which took place during the period of trusteeship, an alleged appropriation of the Corporation's loss in a return filed July 15, 1944, and on dualities which terminated December 31, 1944. Inevitably therefore petitioners relate their claim to the period of trustee operation and bring it within the jurisdiction of the bankruptcy court.

A reorganization proceeding is a judicial proceeding and a reorganization decree is a judgment. The Corporation had every opportunity to litigate its claim in the reorganization court. Having failed to do so the claim is foreclosed by principles of res judicata.

4. *Limitations, laches and estoppel.* Petitioners assert their claim in terms of unjust enrichment. Under California law the applicable period of limitations is two years. This case began more than two years after the 1943 returns were filed and the claim insofar as it relates to 1943 taxes or depends upon the 1943 stock loss is therefore barred. The claim is also barred by laches and estoppel.

5. *The amount of the tax saving.* Neither court below believed the Corporation had a claim and neither court, therefore, had occasion to compute the amount of the tax saving. The calculations of that saving in the record are conflicting, producing results varying from one to seventeen million dollars, depending, first, upon what returns for what years are to be imagined in place of the returns actually filed and, second, upon the treatment to be given

under the assumed returns to such items as loss carry-overs, unused excess profits credits, inter-company interest accruals, accelerated amortization deductions, refund claims, reparation claims and the partial worthlessness of a large debt owing to the reorganization trustees by one of the subsidiaries of the operating company. The calculation of taxes under a consolidated return is always difficult. To calculate taxes under imaginary returns, consolidated or separate, is to invite a nightmare of supposition and counter-supposition from which, thus far at least, the business community has happily been spared. Moreover, the calculation of the tax saving is only half the problem. Then comes the equally difficult question of the amount of the reward to be paid for the tax saving, a question on which petitioners themselves are unable to agree.

Petitioners have only their own interest before them and they are not to be criticized, perhaps, if they refuse to look beyond this case. This Court, however, cannot reckon so narrowly. To accept petitioners' argument would upset thousands of consolidated return transactions now considered closed; it would invalidate by indirection Rule U-45 (b)(6) of the Securities and Exchange Commission; it would require the railroads to revise procedures long accepted as settled; and, most important of all, it would invite tax saving claims nation-wide between husbands and wives, in holding company systems and whenever taxpayers co-operate to achieve a favorable tax result. Petitioners present nothing to justify a revision so radical in accepted procedures.

6. *Rehearing in banc.* Petitioners, relying on Section 46 of the Judicial Code, ask the Court to order all seven

judges of the Court of Appeals for the Ninth Circuit to consider their application for a rehearing by that court in banc. Section 46 provides in part:

> "(c) Cases and controversies shall be heard and determined by a court or division of not more than three judges, unless a hearing or rehearing before the court in banc is ordered by a majority of the circuit judges of the circuit who are in active service. A court in banc shall consist of all active circuit judges of the circuit."

The obvious and controlling purpose of this provision is to permit a panel of three judges to dispose of the case, a result which can be accomplished only if the panel can rule effectively on all matters incident to the decision, including applications for rehearing. There would be little sense to a statute designed to permit a court of seven judges to function by panels of three if every litigant by applying for hearing or rehearing in banc can compel all seven to act. Moreover, any such result is contrary to the statute itself. The statute says that action in banc shall be taken only if a majority of the full court so orders. Petitioners claim they are entitled to compel in banc action upon their application for rehearing. They seek to take to themselves, therefore, a power which under the statute rests exclusively with a majority of the court.

Traditionally, the question of hearing by division or in banc is a question for the court with which the litigants are not concerned and upon which their views are not consulted. A litigant disappointed in the District Court files an appeal. The court, if it likes, can order the case heard in banc even though no request for such hearing is made and even though

both parties oppose it. In similar fashion a litigant loses its appeal and asks rehearing. Again the court, if it likes, can order the rehearing and again it is for the court and not for counsel to say whether the rehearing shall be by division or in banc. When the litigant has applied for rehearing he has done all he can. The problem of whether that rehearing, if granted, shall be by division or in banc is a problem for the court alone, a problem not unlike the problem of determining who among the available judges shall hear the case in the first instance.

Section 46 is immediately responsive to the decision of this Court in *Textile Mills S. Corp. v. Commissioner,* 314 U.S. 326, where, with some difficulty, it was held that a Court of Appeals had power to sit in banc in spite of the provision of 28 U.S.C. Sec. 212 (now Sec. 46(c)) for decisions by divisions. The sole purpose of the section was and is to make it clear that Courts of Appeal have power to conduct in banc proceedings. To grant power to the court to act in banc is one thing; to say, as petitioners say, that the court must act in banc in considering applications for rehearing is quite another. This Court made no such suggestion in the *Textile Mills* case and there is nothing to indicate that Section 46 had any such purpose.

ARGUMENT

I. Petitioners Have No Claim

During the reorganization, consolidated returns were filed in order that income and excess profits taxes should be kept to the least amount permitted by the revenue act. The reorganization trustees received tax advantages through the returns. Now petitioners seek, by a retrospective exami-

nation of the tax proceedings, to make out a claim to the trustees' tax advantage in favor of the holding company. As the trial judge said:

> "Everybody knew that consolidated returns were being filed. Everybody knew who the directors were. Everyone knew that these attorneys were being employed to file this consolidated return. It was all done right out in the open. The question that you have to present in this case is, now, can we go back and under principles of equity, redetermine the transaction on the basis that a legal or equitable wrong was done by what was done." (R. 970-1.)

Petitioners would have the Court belatedly redetermine the transaction in equity and thereby transfer to the holding company the tax advantages of the reorganization trustees, advantages which the reorganization court, and everyone else, knew were being sought for the taxpayer, i.e., for the trustees.

The District Court gave judgment for respondents on the merits. The Court of Appeals affirmed. Both courts have rightly held that there is no equity in petitioners' claim.

A. THE GENERAL RULE. THE CLAIM OF THE HOLDING COMPANY IS CONTRARY TO THE APPLICABLE RULE, UNDER WHICH NO PAYMENT IS MADE FOR "TAX SAVINGS" RESULTING FROM THE USE OF CONSOLIDATED RETURNS.

Since 1918 it has been regular practice for the business community to file consolidated tax returns. From 1928 to 1944, for example, 54,685 such returns, involving more than 176,000 companies, were placed on file.[5] In each of these

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[5] See for 1928-1941, Statistics of Income for 1941, Part 2, p. 293; for 1942, Treasury Press Release No. 44-54, December 31, 1944, p. 16, and No. V-229, February 25, 1946, p. 6; for 1943, Treasury Press Release No. V-229, February 25, 1946, pp. 6 and 10; for 1944, Statistics of Income for 1944, Part 2, Preliminary, pp. 10-11.

50,000 cases the problem of adjusting intra-group rights and liabilities was necessarily presented. The formula which has always been used distributes the actual tax under the consolidated return to the group members in proportion to their respective taxable incomes without "tax savings" payments. No payment in lieu of taxes is made to a parent company or to a loss member of the group for the advantage of the loss in the return.

The Western Pacific group has followed this practice from the beginning (this brief, p. 57).

The Securities and Exchange Commission has noted the customary use of the formula:

> "We note the customary solution of a somewhat similar problem that arises when a group of companies files a consolidated tax return. In assigning to each constituent its fair share of the consolidated tax paid by the group it is usual to divide the actual tax among the companies who would have had to pay a tax on an individual basis. If one of the included companies operated at a loss, the consolidated tax is of course reduced, but *no* part of the 'saving' is ordinarily paid over to the loss company by the other members of the group."[6]

Respondents offered at the trial to support this statement by detailed proof of the business practice as revealed by a special survey of the railroads, the utility systems and representative industrial companies. The proof, excluded as irrelevant (R. 1383), would have demonstrated that business systematically does what respondents say should be done and what was done in this case (R. 1387-93).

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[6]Release No. 53, Accounting Series, November 16, 1945, 3 C.C.H. Fed. Sec. Law Serv. 2d ed., Par. 72,071; 61 P.U.R. (NS) 193, 222, n. 36. Excerpts from the Release are in Appendix B of this brief.

The precedents come mainly from those tribunals and departments of government which are most intimately concerned with holding company systems: the Securities and Exchange Commission, the Treasury Department, and the Federal Trade Commission. Without exception the practice which has been recommended is the practice which was followed in this case. The Interstate Commerce Commission and the semi-official National Association of Railroad and Utilities Commissioners have reached comparable conclusions. There is no contrary view.

The Securities and Exchange Commission Rule Does Not Permit "Tax Saving" Payments for Losses in Consolidated Returns.

The Securities and Exchange Commission has ruled that the proper practice is to allocate pro rata the consolidated tax without "tax saving" payments. Rule U-45(b)(6), adopted for the regulation of public utility systems, forbids intragroup extensions of credit without S.E.C. approval except in certain cases, one of which is:

> "(6) A loan or extension of credit or an agreement of indemnity arising out of a consolidated tax return filed by a holding company (or other parent company) and its subsidiaries: *Provided*, That the top company in the group assumes primary responsibility for the payment of any tax liability involved, subject to the right to contribution from the several members of the group in an amount *not exceeding* as to any company that percentage of the sum of the normal tax, surtax and excess profits tax on a consolidated basis which the sum of the normal tax, surtax and an excess profits tax of such company if paid on a separate return basis is of the aggregate amount of normal, surtax and excess

of reorganization which held worthless the Corporation's interest in the old company. It then became probable, but not certain (see *Insurance Group v. D. & R. G. W. R. Co.*, 329 U.S. 607, 611), that the reorganization plan would thereafter be confirmed by the District Court, that mechanics would be provided for putting it into operation and that at some undetermined date in the future the old stock would be cancelled and affiliation would cease to exist. Nothing else then occurred. The stock of the old company remained in the hands of the Corporation. The affiliation continued. The final "severance" took place May 1, 1944, when affiliation terminated with the surrender of the stock to the Reorganization Committee.

Second. The "economic unity" in the Western Pacific group which, according to petitioners, was severed on March 15, 1943, had never existed. From the outset the majority of the first mortgage bonds of the old company were with the public (34 F. Supp. 493, 497). As the financial condition of the old company became more critical, the value of the stock interest disappeared and the company belonged in truth and in equity to its bondholders. *Helvering v. Cement Investors*, 316 U. S. 527, 532; *United States v. Butterworth-Judson Corp.*, 269 U. S. 504, 513. There was no "economic unity." It could not, therefore, have been severed on March 15, 1943.

Third. "Economic unity" in matters related to consolidated returns is a false factor demonstrably of no significance. Rarely, if ever, does "economic unity" exist in holding company systems. Only in the exceptional case does the parent company completely own the subsidiaries. More often the parent, by voting control, controls properties which in reality belong to the public through the purchase

of senior securities.[28] The revenue acts recognize this diverse economic interest in the ordinary holding company system and they make no requirement of economic unity as a condition for filing consolidated returns. They require only that there be "affiliation," i.e. that 95% of the equity and voting stock be held within the group (I.R.C. Sec. 141).[29] Thus in emphasizing economic unity petitioners would have the Court accept the rare situation as the ordinary situation

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[28]Summary Report of the Federal Trade Commission on Economic Financial and Corporate Phases of Holding and Operating Companies of Electric and Gas Utilities, Part 72-A, Sen. Doc. No. 92, 70th Cong., 1st Sess. See, for example, p. 311:

> "On the other hand, the long-term debt of the operating companies consists mostly of bonds which are secured by the mortgage on their physical properties. The long-term debt together with preferred stock usually represent the capital obtained from the investing public. The common stock of the operating companies is usually the voting stock and is owned by the holding companies for control purposes."

See, also, Barnes, *The Economics of Public Utility Regulation* (1947), p. 73; Bonbright and Means, *The Holding Company* (1932), p. 147; 2 Dewing, *The Financial Policy of Corporations* (4th ed. 1941), p. 1042. Dewing reports that in seven large holding companies, a total of 52% of the bonds, 32% of the preferred stock and 16% of the common stock was publicly held (p. 1051).

[29]Since 1918 the Revenue Acts have progressed steadily away from any theory of economic unity or common ownership as far as consolidated returns are concerned. The 1918 statute defined affiliation in general terms of ownership or control (Section 240b). By progressive steps through the Revenue Act of 1924 and the Revenue Act of 1928 the theoretical approach has been abandoned in favor of a technical requirement—ownership of 95% of the voting stock. See 8 Mertens, *Law of Federal Income Taxation* (1942) Sec. 46.13, p. 426.

The cases talk from time to time of a single business enterprise, but whenever it is important they have recognized that the test is what the statute requires and nothing more. See *United States v. Donaldson Realty Co.*, 106 F.2d 509, 517; *Commissioner v. General Gas & Electric Corp.*, 72 F.2d 364; *Erie Lighting Co. v. Commissioner*, 93 F.2d 883. The basic theory of consolidated returns is of course that the returns serve only as a method of computing the tax owing by the individual group members who are and remain the taxpayers. See *Helvering v. Morgan's, Inc.*, 293 U.S. 121, 127.

if the law requires such payments, Rule U-45(b)(6), which in effect forbids them would be invalid.

The Treasury Department Employs the General Rule.

The rulings of the Treasury Department assume and provide for a pro rata allocation of the consolidated tax without tax saving payments. The formula appeared in the Revenue Acts of 1921, 1924 and 1926.[9] In 1928 Congress made all members of an affiliated group (except for a few special occasions) responsible for the full amount of the tax[10] and no allocation formula has since appeared in the statute. For special occasions, however, such as allocating consolidated excess profits tax to provide deductions from normal tax net income, the Treasury has designated the customary formula[11] and the Bureau of Internal Revenue has ruled that it is to be used to determine earnings and profits available for dividends.[12]

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[9]Section 240(b) of the Revenue Act of 1921 provided:

> "(b) In any case in which a tax is assessed upon the basis of a consolidated return, the total tax shall be computed in the first instance as a unit and shall then be assessed upon the respective affiliated corporations in such proportions as may be agreed upon among them, or, in the absence of any such agreement, then on the basis of the net income properly assignable to each."

An identical provision appeared in the Revenue Acts of 1924 and 1926.

[10]See Art. 15(a) in Treas. Regs. 75 (1928), 78 (1932), 89 (1934), 97 (1936), 102 (1938), and Treas. Regs. 104, Sec. 23.15(a) (1942). Sec. 23.15(b) of Treas. Regs. 104, cited by the Corporation (its brief, p. 66), did not define the tax liability of bankruptcy trustees who joined in consolidated returns, but operated to limit the liability of such trustees.

[11]See T.D. 5086, Amendments to Regulations 103, 1941-2 Cum. Bull. 46-7. An excerpt from the text is in Appendix B, p. 28.

[12]I.T. 3637, 1944 Cum. Bull. 258, I.T. 3692, 1944 Cum. Bull. 261, and I.T. 4085, 1951-1 Cum. Bull. 68. The texts are in Appendix B,

The Federal Trade Commission Investigated and Condemned "Tax Saving" Payments to Holding Companies for Taxes Saved by Consolidated Returns.

The Federal Trade Commission has approved the formula which respondents defend and condemned the formula which petitioners propose. The Corporation, as parent, proposes that it should receive from the group members a "tax saving" payment equal to the tax which each group member would have paid had it filed a separate return. This practice, as adopted in the 1920's by a few of the more notorious utility systems, was one reason why the Securities and Exchange Commission was created. The Federal Trade Commission conducted an extensive investigation of the utilities prior to the enactment of the Public Utility Holding Company Act and condemned the practice which petitioners ask this Court to establish as law, saying:

> "Holding companies are not justified in recording as income the savings from this procedure of handling Federal income-tax payments. *The subsidiary com-*

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pp. 20, 25, 26. The consolidated return regulations (Treas. Regs. 104 and 110) assume that the tax allocation will be in accordance with the accepted formula. There are no specific provisions since before now it has never been suggested that consolidated returns required any "tax saving" payment. The regulations contain, however, provisions which are plainly inconsistent with petitioners' proposal. They require, for example (Treas. Regs. 104, Sec. 23.34 (c)), that whenever income of a parent company is offset in a consolidated return by the loss of a subsidiary (which could not have been availed of by the subsidiary in a separate return), the tax basis upon which the parent holds the stock of the subsidiary must be reduced in an amount equal to the loss. Then upon liquidation or sale of the stock of the subsidiary the amount of gain on which the parent must pay tax is increased. This rule was first developed in the decisions. See *Jordahl & Co.*, 35 B.T.A. 1136, 1139. Plainly neither the courts in adopting this rule nor the Commissioner in formalizing it in the regulations intended that the one group member should pay another for the tax benefit of its loss. This would require a double payment for the tax benefit: once to the loss company and once to the Government in increased taxes through reduction in the tax basis of the stock.

panies in a holding-company group are entitled to the benefit of any savings to the group due to filing a consolidated income-tax return. Only the amount of Federal income tax paid by a holding company on the basis of a consolidated return should be borne, in proportion to the taxable income, by those companies having taxable income, for which companies a consolidated return was filed. Stated differently, each company in a holding-company group should pay only its pro-rata share of the tax paid for the group." (Emphasis supplied.)[13]

Petitioners are asking the Court to adopt a practice which Congress intended that the Securities and Exchange Commission should eliminate in the utility field and which has been eliminated.

The Interstate Commerce Commission Has Disapproved "Tax Saving" Claims.

There is no formal ruling by the Interstate Commerce Commission on the proper allocation of taxes under consolidated returns, perhaps because, as respondents offered to prove (R. 1387-93), the railroads universally employ the traditional formula. The Commission has considered occasional "tax saving" claims and has rejected them.[14]

Doubtless the Commission would disallow a "tax saving" payment to a parent company as an expense. All that could be charged as an expense would be a proper allocation to

[13]Summary Report of the Federal Trade Commission to the Senate of the United States pursuant to Senate Resolution No. 83, 70th Cong., 1st Sess., on Economic, Financial and Corporate Phases of Holding and Operating Companies of Electric and Gas Utilities, Part 72-A Sen. Doc. No. 92, 70th Cong., 1st Sess., p. 479. This report is quoted at greater length in Appendix B, p. 5.

[14]*Central of Georgia Railway Co. Reorganization*, 252 I.C.C. 587, 600; *St. Louis-San Francisco Railway Co. Reorganization*, 257 I.C.C. 399, 410.

the operating company of its share of the *actual cost* of services rendered by the parent, *Smith v. Illinois Bell Tel. Co.*, 282 U. S. 133, 157; cf. *Galveston Elec. Co. v. Galveston*, 258 U.S. 388, 399. The National Association of Railroad and Utilities Commissioners, of which the Interstate Commerce Commission is a member, has disapproved the treatment of a "tax saving" as an expense.[15] Petitioners, whose claim here is asserted as an expense of the reorganization trustees,[16] are asking the Court for a ruling that will invite the Commission to revise its views.

No Court Has Approved a Claim for Taxes Saved by Consolidated Returns.

The absence of judicial decisions is further proof of the general acceptance of the rule. In the few cases which have been concerned with intergroup relationships, a "tax saving" claim has never been approved.[17]

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[15] Reports of the Committee on Accounts and Statistics of the National Association of Railroad and Utilities Commissioners, for 1943, at pp. 255-6; for 1945, at pp. 458-60. Material from these reports is quoted in Appendix B, p. 17.

[16] Petitioners insist that theirs is a claim for *expense* incurred by the reorganization trustees (Corp. brief, p. 49, Interveners' brief, p. 90). They are not asking for dividends.

[17] In *Koppers Co.*, 8 T.C. 886, 11 T.C. 894, the intra-group settlement was in conformity with the usual practice. This was true though there was no "economic unity" within the group. See Moody's Industrial Manual, 1941, p. 2598. *Bankers Trust Co. v. Florida East Coast Car Ferry Co.*, 92 F.2d 450, also suggests approval of the general rule for tax allocation. Moreover, the case is direct authority for the proposition that any refund on account of the 1942 taxes would belong not to the petitioners but to the trustees. *Beneficial Corp. v. Commissioner*, 18 T.C. ......, No. 47 (May 23, 1952), disallows a claim for treatment of a "tax saving" from consolidated returns as an expense. There a holding company, contrary to the general rule, had collected "tax savings" from its subsidiary. The court held the amounts so paid to the holding company by its subsidiary were in fact dividends and treated them as such

These are the rulings now available on the specific question before the Court. They reach a single and unanimous conclusion: that consolidated returns do not create claims for "tax saving" payments.

There Is Nothing in the Revenue Acts to Require a Departure from the Rule.

The argument that Congress in enacting the revenue acts had some purpose to benefit parent companies in holding company systems is without foundation. There are a number of reasons.

The revenue acts create no private rights. They collect revenue to pay the expense of government. *Meriwether v. Garrett*, 102 U.S. 472, 513. Indeed, if a tax law requires the payment of money from one private person to another, it becomes unconstitutional. *United States v. Butler*, 297 U.S. 1, 61.

There is nothing either in the material quoted by petitioners or elsewhere in the extensive history of consolidated returns[18] to indicate that Congress intended to confer a special benefit on holding companies. The true purposes of consolidated returns are well understood. They are, first, to facilitate the administration of the tax laws by relieving the Treasury of the burden of reallocating income and deduc-

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for tax purposes. In the unreported decision *In re Missouri Pacific Railroad Co.*, Docket No. 6935 (E.D. Mo. 1947), a subsidiary by joining in consolidated returns was faced with an actual cash loss in increased taxes. The group paid the subsidiary not the amount by which the loss benefited the group but rather the amount of actual damage to the subsidiary from the returns. In fact, the order was in strict conformity to Rule U-45(b)(6) of the S.E.C. See the text of the order, Appendix C, p. 34.

[18] A tabulation of this material appears in Appendix B, p. 29.

tions on transactions between affiliated companies[19] and, second, to do tax justice between businesses organized as subsidiaries on one hand and businesses organized by departments on the other.[20] In a business organized by departments the losses of one department offset the income of another. If the same business were organized by subsidiaries this offsetting, without consolidated returns, would not take place. Consolidated returns collect an equal tax

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[19]The House Ways and Means Committee reported as follows on the Revenue Act of 1934:

> "Your committee considered at length the question of abolishing the consolidated return. Our subcommittee originally recommended this action. The Treasury believed this policy undesirable. The Treasury pointed out that the one way to secure a correct statement of income from affiliated corporations is to require a consolidated return, with all intercompany transactions eliminated. Otherwise, profits and losses may be shifted from one wholly owned subsidiary to another, and their separate statements of income do not present an accurate picture of the earnings of the group as a whole. * * * The administration of the income tax law is simpler with the consolidated return since it conforms to ordinary business practice; enables the Treasury to deal with a single taxpayer instead of many subsidiaries; and eliminates the necessity of examining the bona fides of thousands of intercompany transactions." H. Rep. No. 704, 73d Cong., 2 Sess., p. 16.

See, also, S. Rep. No. 960, 70th Cong., 1st Sess., pp. 1, 13, 29; Hearings of House Ways and Means Committee on Revenue Revision, 1934, pp. 86, 99; Report of the Joint Committee on Internal Revenue Taxation on the Revenue Act of 1926, p. 63.

[20]See Memorandum of the Finance Committee of the Senate on the 1918 Act:

> "Where a corporation does business through subsidiary corporations, such subsidiaries represent in effect merely different departments of one business. It is just as illogical to tax these subsidiaries separately as it would be to levy a separate tax upon the profits earned by different departments of a single corporation." (p. 9.)

See, also, Report of Senate Finance Committee on the Revenue Bill of 1928 as quoted in the Hearings before the Senate Finance Committee on the Revenue Act of 1932, p. 24; S. Rep. No. 665, 72d Cong., 1st Sess., p. 9.

from both enterprises. There is nothing here to suggest that Congress has any particular regard for holding companies.

Petitioners' argument is founded upon a singularly unsophisticated view of holding company systems. Petitioners would have the Court believe that the holding company systems which file consolidated returns are single ownerships. Nothing could be further from the truth. Consolidated returns can be filed if and whenever 95 per cent of the equity and voting stock is within the system. (I.R.C. Sec. 141(d)).[21] This says nothing about minority holdings, nor about preferred stock and senior securities such as notes and bonds. Those securities are normally in the hands of the public, *North American Co. v. S.E.C.*, 327 U.S. 686, 701. No one knows this better than Congress and it is hardly likely that Congress which has in general been hostile to holding companies would intend by consolidated returns to confer an advantage on those holding companies at the expense of their subsidiaries, the operating companies owned in truth by the public.

Committees of Congress Have Investigated and Condemned "Tax Saving" Payments to Holding Companies for Taxes Saved by Consolidated Returns.

In considering the bill which eventually became the Public Utility Holding Company Act of 1935, the Congressional Committees were sharply critical of the practice which petitioners now advocate, that is, a practice whereby the parent company takes to itself the benefit of group "tax savings." For example, Senator Wheeler, chairman of the

[21] It does not have to be held directly by the parent company. Subsidiaries can hold stock of the parent and of other subsidiaries (I.R.C. Sec. 141(d), Appendix A, p. 2). Petitioners who claim a special privilege for the top parent ignore these situations.

Senate Committee on Interstate Commerce, in speaking of this practice said of the holding companies:

"The Chairman. What they did, according to the testimony here, was this. They went out and collected money from the operating companies as income taxes, in the amount that the local company would have to pay. It was paid into the holding company, and then the holding company, as a matter of fact, under the consolidated returns that they had made, and under the arrangements which they could make, made large profits in their income tax. In other words, they charged up to A, B, and C companies a certain amount of income tax that they said they would have to pay to the Government, and then they took that money. They acted as tax collectors, but they paid in only a portion of it, a half of it, or perhaps a third.

Mr. DeVane. It was $11,000,000 that they collected, and they paid $2,000,000.

The Chairman. So that, as a matter of fact, they took that $9,000,000, which should have gone either to the Government, or, if it was not necessary to pay it to the Government, then it should have gone back to the operating company."[22]

References to similar comments on petitioners' position are noted in the margin.[23] Thus to the extent that Congress has indicated a preference as to who should receive the benefits of "tax savings" from consolidated returns it has taken a

[22]Hearings before the Senate Committee on Interstate Commerce, 74th Cong., 1st Sess., on S. 1725, p. 255.

[23]Hearings before the Committee on Interstate and Foreign Commerce, House of Representatives, 74th Cong., 1st Sess, on H.R. 5423, pp. 153, 849, 992, 1061, 1522; Hearings before the Committee on Interstate Commerce, United States Senate, 74th Cong., 1st Sess. on S. 1725, pp. 83, 122, 255, 557, 822, 873-4.

position precisely contrary to that for which petitioners argue.

The Rule Is in Accordance with Sound Policy.

The rule against payments for "tax savings" is supported by sound policy. The reasons include:

First. The fact that the Revenue Acts do not create private rights. A tax is an impost levied by the Government to obtain revenues to maintain its existence. *Meriwether v. Garrett*, 102 U.S. 472, 513-14. It creates no private rights. *United States v. Butler*, 297 U.S. 1, 61.

Second. The fact that "tax saving" payments, if allowed, would contravene the policy against merchandising tax advantages. Transactions which have only a tax purpose are not recognized by the tax law. *Gregory v. Helvering*, 293 U.S. 465; I.R.C. Sec. 129. "Tax saving" payments, if approved, would offer new opportunities for tax avoidance and provide a new motive for distorting business transactions with relation to the tax law.[24]

Third. The fact that "tax saving" payments, if required, would create great uncertainties in the law. Husbands and wives file joint returns (I.R.C. Sec. 51(b)); stockholders to save taxes sell the stock of a business rather than its assets, a lawyer sends a December bill to make a deduction available to his client in the current tax year. Do these ordinary transactions create claims for taxes "saved"?

Fourth. The fact that a requirement of "tax saving" payments would unnecessarily complicate the tax system. Taxation "can never be made simple but we can try to

[24] Cf. *Young v. Higbee Co.*, 324 U.S. 204, 210, holding that the right of appeal given by the law could not be sold when that would produce a result contrary to the policy of the statute.

avoid making it needlessly complex." *Dobson v. Commissioner*, 320 U.S. 489, 495. To impose upon an already complex tax system a complementary system of "tax saving" payments would unnecessarily multiply the complexities of tax administration.

The settled practice against "tax saving" payments should not be disturbed.

The Rule Is Fair and Equitable.

The rule applies in cases where there are diverse interests —to affiliations in which creditors and stockholders of the several companies in the chain, as well as the public served by operating members of the group, have rights and interests distinct from the rights and interests of the parent company. In fact the rule is called into being for such cases, to supply a formula that protects against upstream payments of "charges in lieu of taxes" at the expense of operating subsidiaries and the holders of their securities.

In all such cases, the revenue act grants the privilege of filing the consolidated return to the group. The parent company files the return and each of the other members consents to it, I.R.C. Sec. 141. According to petitioners, this means that every loss parent is entitled to a price for its joinder.[25]

The law requires no such unhappy result. There is nothing about the tax advantage of a loss in a consolidated tax return to create a claim for compensation. The only service provided by the loss company is the nominal one of indicating its acquiescence in the return. Nothing else is

[25]Petitioners seem to think that other loss members are in a different position. Why? They too must consent. Their losses have equal efficiency in reducing taxes. A loss under Section 23(g)(4) can be the loss of a subsidiary company in the chain.

taken from or provided by the loss company. The other group members benefit from the loss because the revenue act computes the tax by offsetting it against their earnings. But the loss company has no claim on that account because it does nothing to bring the benefit about—it contributes no service, no effort, no property or asset of any kind.

For obvious reasons, the rule gives nothing for an assumed power to bargain. If one group member can bargain all can bargain and the net result would be to reward the most recalcitrant. Affiliated companies must deal decently with each other. Their claims *inter se* are measured by justice and the law, not by a supposed power to impose unnecessary taxes.

The rule is fair. It applies equally to all group members all the time. It leaves with each the possibility of tax reduction from the coincidence of loss and gain, and protects each against claims in lieu of taxes arising out of such coincidences. No one, looking forward, can say whether a system of tax saving payments would leave him richer or poorer. Is a group member entitled to speculate on ameliorating its losses by collections from its affiliates? Equity demands no such uncertainty and confusion. Its demands are satisfied by equality, by a rule that applies equally to each member of the group and leaves to each what the revenue act leaves to it, namely, its earnings net after taxes.

The rule conforms to *Phillips-Jones Corp. v. Parmley*, 302 U. S. 233, which says that the applicable law is the equitable rule of contribution. Under that rule each taxpayer pays his share of the tax, and no more. It conforms to the principles laid down in *Southern Pacific v. Bogert*, 250 U. S. 483, and in *Taylor v. Standard Gas & Electric Co.*, 306 U. S. 307. Within the scope of the principles applied in those cases is the old-

fashioned idea that management must act with reasonably good judgment and cannot charge a price for preferring a good course of action over a bad one.[26] When the desirable choice between returns is as plain as it was in the circumstances of this case, consolidated returns are filed because good management requires that course. This neither justifies nor permits a charge for the "service."

One final point should be made as to the law arguments which petitioners advance. Those arguments are founded upon doctrines of unjust enrichment and duality which have been in the law for many years. Never, however, have these arguments, or an assumed purpose of Congress in connection with consolidated returns, led to the conclusion which petitioners argue. On the contrary, every tribunal, every informed person who has considered the problem, has reached the opposite conclusion.

The Rule Has Been Followed from the Beginning by the Western Pacific Group.

Since 1918 the Western Pacific group has filed consolidated tax returns (Ex. D. 40, R. 1504). At the direction of the Corporation the tax under the consolidated return has been allocated to the group members in proportion to net income (R. 1262). There has never been a "tax saving" payment (Ex. D. 40, R. 1504, 1262).[27] On many occasions this practice

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[26]Cf. *Smith v. Illinois Bell Tel. Co.*, 282 U.S. 133, 157, referring to an allocation of the charges for the parent company's services based on the cost of the service to the parent company.

[27]Ex. D. 40, a printed Price Waterhouse & Co. report, shows that interveners (Int. brief, p. 70) are mistaken in referring to payments by Utah Fuel as made for "tax savings." Actually, a net payment was made by the Corporation under agreements whereby the Corporation undertook to absorb certain Utah Fuel taxes in connection with transactions in which the Corporation received a large dividend from Utah Fuel and made an agreement with the Missouri Pacific respecting the reorganization of the D. & R. G. W. R. Co. See pp. 1-2, 3-15, of the report, particularly note 2, pp. 5-6.

resulted in tax reductions for the Corporation. In each year from 1924 to 1935 the Corporation received a "tax saving" because the loss of another group member was included in consolidated returns (Ex. D. 40, R. 1504, 1552, 2040). The tax thus "saved" totaled $593,976.33 (R. 1552, 2040). No payment was made for that saving (R. 1262, Ex. D. 40).

The established rule was followed for each of the years in question. Only long after the event, after the returns were on file, after the reorganization trustees were discharged, after the reorganization proceeding was closed, after it was no longer possible for the trustees to file separate returns and take advantage of deductions unavailable under consolidated returns was this claim asserted. It is, as the court below pointed out, "an afterthought" (R. 274), a tribute to a lawyer's ingenuity. It has no substance. But if petitioners should be successful they will impose upon respondents a total burden of taxes and "tax saving" payments far in excess of the original tax obligation to the Government.

B. NOTHING IN THE CIRCUMSTANCES OF THIS CASE TAKES IT OUT OF THE GENERAL RULE OR GIVES TO THE HOLDING COMPANY A "TAX SAVING" CLAIM.

According to the general rule there is no right to payment for a "tax saving." Petitioners cannot succeed unless they show some special reason why they should be relieved from the rule. This they fail to do.

After the order of October 11, 1943, confirming the plan, it was theoretically possible, *Insurance Group v. D. & R. G. W. R. Co.*, 329 U.S. 607, 611, 618-9, that the Corporation might be readmitted to participation, but for practical purposes it was clear that at some date not far in the future the

Corporation would be required to surrender its stock in the debtor company.

This meant that the Corporation could not expect to derive indirect benefit from the trustees' "tax savings."

There is nothing in this to take the case out of the rule. The rule was not made exclusively for prosperous parent companies. It denies to subsidiaries the right to "tax saving" payments although they normally receive no benefit, direct or indirect, from the tax advantage of their losses. The rule was made for loss parents, too. There is nothing to suggest that its application depends on the financial condition of the group members, or upon the fact or degree of indirect benefit to the loss member.

The consummation of the plan excluded the holding company from participation. This proves that it is not entitled to a benefit. It affords no reason for repudiating the holding company's own practice of 25 years or for making a preferential payment to the parent company in violation of the established rule.

Thus it is clear that the special circumstances of the case provide no reason for a departure from the established rule.

The Alleged Severance of "Economic Unity" Affords No Reason for Taking the Case Out of the Rule or for a "Tax Saving" Payment to the Holding Company.

Petitioners argue that this Court's decision of March 15, 1943 (318 U. S. 448) approving the reorganization plan "severed the economic unity" of the group and thereby created circumstances requiring a special conclusion. This argument has no substance.

First. The decision "severed" nothing. On that date the Court approved the Interstate Commerce Commission's plan

and give significance to a factor to which Congress has attached no significance.

Fourth. The accepted formula for the settlement of intragroup liabilities in connection with consolidated returns makes nothing turn on economic unity. The Securities and Exchange Commission, the Treasury Department and the Federal Trade Commission are all intimately concerned with holding company groups. The officials of those tribunals are thoroughly familiar with the fact that ordinarily there is no economic unity within the group. They have nevertheless ruled that the intragroup settlement should be made without "tax saving" payments. No exceptions are stated in terms of "economic unity."

Fifth. The assumption by petitioners that a holding company in ordinary course receives the benefit of all "tax savings" to its subsidiaries is contrary to fact. Petitioners suggest that every benefit to a subsidiary is a benefit to the parent. This Court has reached a contrary conclusion. "So various are the possible permutations and combinations of the economic factors that equivalence of surplus or deficit in the accounts of the subsidiary with the gain or loss to the parent would be mere coincidence." *Commissioner v. Phipps*, 336 U.S. 410, 421, n. 15. The Treasury Department agrees: "Moreover, there is no reason for the assumption that the entire earnings of a subsidiary would become dividends to the parent" (Treasury Department release of June 9, 1948, "Consolidated Returns and Intercorporate Dividends," p. 12). If, to take some obvious examples, bonds are in default, debenture interest unpaid, preferred stock in arrears or general creditors unsatisfied, the benefit of any tax reduction on account of consolidated returns never reaches the parent.

There Is Nothing Special in the Holding Company's Position as Parent or as Loss Company.

In the final analysis the Corporation's position in this case has two elements: that of a parent company and that of a group member whose loss was claimed as a deduction in a consolidated return. The Corporation *as parent* has no right to take to itself the "tax savings" realized by its subsidiaries through the consolidated returns. That abuse of the holding company position has been condemned.

As a loss company receiving no benefit from the loss the position of the Corporation is not improved. The entry of a loss in a consolidated return produces no right to compensation in the loss company. This can be demonstrated by the general business practice, the past practice of the Western Pacific group and all the relevant rulings. Subsidiaries usually receive no benefit from the "tax savings" to the group through their losses. Nevertheless, the subsidiaries never receive "tax saving" payments. If the entry of a loss in a consolidated return entitles the loss company to compensation because it otherwise has no benefit, virtually every intragroup settlement in the past thirty years has been improper and public investors in subsidiary companies have been unlawfully deprived for thirty years of an asset to which they were entitled.

As "Former Parent" the Holding Company Can Neither Escape the General Rule nor Claim an Equity.

Petitioners' claim to a special equity comes to this: that the Corporation's position is different from that of the normal parent company. What is the difference? It is not that the Corporation had a loss that went into the returns. It is not that the tax law and regulations permitted separate or

consolidated returns. These things are characteristic of all the cases to which the general rule applies. In most cases the parent company may have an indirect benefit from the tax saving. Petitioners say their case is different because here that chance did not exist. Theirs is not the only case; it is usually true that subsidiaries cannot reach the assets of their affiliates, and no doubt the same is true at times of other parent companies. The rule is not qualified in favor of holding companies who are in financial difficulty.

Furthermore, the difference is not an equity. It is a statement that the parent's equity has been lost. We have seen that as parent the Corporation has no claim. As former parent, it can have no better right.

Petitioners are not helped by describing an ex-parent as a "stranger." As a stranger, the Corporation no longer has an equity but claims a supposed freedom to impose additional taxes on the trustees by choosing to file separate returns. That argument is fallacious.

C. THE FALLACIES IN PETITIONERS' ARGUMENT THAT THE HOLDING COMPANY WAS FREE TO MAKE A CHOICE OF RETURNS: (1) THE HOLDING COMPANY WAS BOUND TO FILE CONSOLIDATED RETURNS, AND (2) IT COULD DERIVE NO EQUITY FROM A SUPPOSED POWER TO WITHHOLD ITS CONSENT.

Petitioners insist that the Corporation was free to impose $17,201,739 additional taxes on the trustees by filing separate returns. They seem to think that the major premise of their claim is this supposed freedom of the holding company. It is this, they say, which gave it a right to bargain, or as the Corporation puts it, gave rise to a claim for the tax value of its loss. It is this, they say, which gives significance to the dualities upon which they so heavily rely.

There are two fallacies in the argument: first, the Corporation had no choice, and second, if it had been free to choose, that would have given it no right in the tax savings.

The Holding Company Was Obliged to File Consolidated Returns.

Under the circumstances of this case the Corporation was specially obliged to co-operate to reduce the trustees' taxes. It was not a stranger. Its obligation arose from the circumstances (1) that for upwards of twenty years it had used the accepted formula, and had received and retained the benefit of "tax savings" from its affiliates' losses (this brief, p. 57), (2) that in prior years there had accumulated credits and carry-overs resulting from the trustees' operations, which, because the returns for those years were consolidated, would be lost unless the returns for the years here in question should be consolidated,[30] (3) that the Corporation had no income and no use for its loss, (4) that the Corporation as parent was under fiduciary duties to its insolvent subsidiary's creditors, and (5) that as sole stockholder it was required by the Bankruptcy Act so to act as to preserve the estate.

The reorganization court would have required the Corporation to sign the returns without a "tax saving" payment. The reorganization court had power to compel the Corporation to sign the returns, had it proved recalcitrant. A bankruptcy court has the powers of a court of equity, *Young v. Higbee Co.*, 324 U. S. 204, 214; *S. E. C. v. United States Realty Co.*, 310 U. S. 434, 455. As such, it has full power in a reorganization proceeding to protect the assets of the estate.

[30] \$5,773,937 of the claimed \$17,201,739 tax saving represents the tax advantage of the trustees' carry-overs and credits as calculated by the petitioners (this brief, p. 113).

"The jurisdiction of the bankruptcy court in Chapter X proceedings to protect and preserve the property of the bankrupt estate was not in question and could not be questioned." *Duda v. Sterling Mfg. Co.*, 178 F.2d 428, 434. In the exercise of that jurisdiction the reorganization court would have compelled the Corporation, a party to the reorganization proceeding,[31] to join in the returns and thus to conserve the assets of the bankruptcy estate. As sole stockholder of the old company, and initiator of the reorganization proceeding, the Corporation had general fiduciary duties to its subsidiaries, particularly in the interest of the latter's creditors. *Consolidated Rock Products Co. v. DuBois*, 312 U. S. 510, 522, 524, *Pepper v. Litton*, 308 U. S. 295, as well as special duties arising out of the bankruptcy proceeding to conserve the assets for the benefit of creditors.[32] Under such circum-

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[31] *Callaway v. Benton*, 336 U.S. 132, upon which appellants rely, involved the power of the reorganization court over a stranger to the proceeding.

[32] Compare 3 *Collier on Bankruptcy* (14th ed.) Par. 62.30, p. 1573: "Among [the duties of the bankrupt] is the duty to preserve the estate for the benefit of the creditors and to do whatever is needed to protect the assets from deterioration until, either a custodian or a receiver or the trustee has taken charge of them. This duty is not specifically mentioned in the statute, but has been recognized by the courts." See, also, *In re Hines*, 69 F.2d 52; *Sellers v. Bell*, 94 Fed. 801, 809; *In re Beck*, 92 Fed. 889, 891; *In re Connecticut Co.*, 95 F.2d 311, 315, cert. den. 304 U.S. 571. The obligations of the debtor are binding upon the stockholders of the debtor. Sec. 77(l) provides in part: "In proceedings under this section * * * the duties * * * of all persons with respect to the debtor and its property, shall be the same as if a voluntary petition for adjudication had been filed * * *." And Sec. 7b of the Act provides in part: "Where the bankrupt is a corporation, * * * its stockholders or members, or such of them as may be designated by the court, shall perform the duties imposed upon the bankrupt by this Act." See, e.g., *Goldie v. Cox*, 130 F.2d 695; *In re Songood Realty Co.*, 32 F. Supp. 121. See, also, *In re Floyd's Estate*, Del. Co. Orphans Ct., No. 113 (Pa. 1950), 51-2 U.S.T.C., Par. 9415, where a probate court ordered a recalcitrant executrix to sign a joint in-

stances the reorganization court would never have allowed the Corporation to deplete these assets by demanding payment for signing a paper.[33]

The Court of Appeals was right in holding that the Corporation "was under a duty to deal fairly with the subsidiary having full regard for the interests of the creditors and holders of other securities" and that "It owed a duty not to require its subsidiary to forego a legitimate tax saving and could not bargain to perform its duty" (R. 2234). In so holding the Court of Appeals followed the rulings of this Court, among them *Consolidated Rock Products Co. v. DuBois*, 312 U.S. 510, 522, where it is said:

> "A holding company, as well as others in dominating or controlling positions (*Pepper v. Litton*, 308 U. S. 295),

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come tax return of the decedent and his former wife because it would "save the estate considerable expense in that the estate will be able to take advantage of the benefits to be derived from the split income provisions of the Internal Revenue Code."

[33] A reorganization court pays nothing for nuisance value. "In these proceedings there is no occasion for the court to yield to such pressures." *Case v. Los Angeles Lumber Co.*, 308 U.S. 106, 129. Moreover, if appellants had exacted a price for a signature to the consolidated returns they would have been forced to return the exaction thus collected. Cf. *Young v. Higbee Co.*, 324 U.S. 204, 214. It is not common practice to require payment for the service of signing a paper and the cases are not numerous. They agree, however, in requiring repayment of the price exacted. See *Kelley v. Caplice*, 23 Kan. 337, aff'd on rehearing, 27 Kan. 359; *Guetzkov Bros. Co. v. Breese*, 96 Wis. 591, 72 N.W. 45; *Lain v. Rennert*, 308 Ill. App. 572, 32 N.E.2d 375; *Oswald v. El Centro*, 211 Cal. 45, 292 Pac. 1073; *American Bank & Trust Co. v. Federal Reserve Bank*, 256 U.S. 350; *Rees v. Schmitz*, 164 Ill. App. 250. Cf. *Union Pac. R.R. Co. v. Public Service Comm.*, 248 U.S. 67, and cases cited in the dissenting opinion in *United States v. Bethlehem Steel Corp.*, 315 U.S. 289, 326-30. The contention, moreover, that a hard bargain should have been made with the trustees has no merit in an equity court. "The complaint that its board of directors did not drive a harder bargain, or the hardest bargain, that it might have driven should have no appeal to a court of equity. On the contrary, courts of equity often proceed upon a contrary and opposite theory." *Atwater v. Wheeling & L. E. Ry. Co.*, 56 F.2d 720, 724.

has fiduciary duties to security holders of its system which will be strictly enforced. See *Taylor v. Standard Gas & Electric Co.*, 306 U. S. 307."

See, also, *In re Commonwealth Light & Power Co.*, 141 F.2d 734, 736, and *Comstock v. Group of Institutional Investors*, 335 U. S. 211.

The Corporation's Obligation to File the Returns Survived the Termination of Affiliation.

The fact that the returns for 1943 and 1944 were physically filed after the Corporation surrendered its stock does not affect the Corporation's obligations. As required by the statute, the returns related to the period of affiliation, and the obligations of the parties with respect to them were therefore the obligations of the affiliation period. The obligations of a fiduciary upon termination of the relationship continue unimpaired with respect to all past transactions and the incidents of winding up. The rule applies to all fiduciary relationships: partnerships, agencies, trusts and corporate affairs.[34]

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[34] *To Partnerships:* "On dissolution the partnership is not terminated, but continues until the winding up of partnership affairs is completed." Uniform Partnership Act, 7 U.L.A. Sec. 30; Cal. Corp. Code Sec. 15030.

To Agencies: "The duty of an attorney to be true to his client, or of an agent to be faithful to his principal, does not cease when the employment ends, and it cannot be renounced at will by the termination of the relation. It is as sacred and inviolable after as before the expiration of its term." *Trice v. Comstock*, 121 Fed. 620, 625.

To Trusts: "When the time for termination of the trust has arrived, the duties and powers of the trustee do not immediately cease, but until the trust is actually wound up, he has such duties and powers as are appropriate for the winding up of the trust." 3 *Scott on Trusts* (1939) Sec. 344.

To Corporations: "* * * by statute in most jurisdictions it is now provided that upon the dissolution of any corporation in any

The Corporation had, therefore, fiduciary obligations with respect to the tax transactions which were entirely unaffected by the date the returns happened to be filed. Those fiduciary duties required that the Corporation co-operate in mimimizing the trustees' taxes. As fiduciary, the Corporation was not entitled to prefer its own interest over the interest of the unpaid creditors by demanding a "tax saving" payment on account of an entry in the tax returns which cost it nothing. The fiduciary obligations which the law recognizes for the circumstances of this case deprived the Corporation of any choice about the kind of return to file.

The Power to Choose Between Returns Is Not the Source of Any Equity and the General Rule Makes No Allowance for Such a Power.

It is not significant under the general rule that the revenue act frequently affords a choice between separate and consolidated returns.[35] The rule provides a formula to determine the obligations of the group members between each other whenever consolidated returns are filed. It does not distinguish between the cases in which there is a choice and cases in which there is none.

The claim of parent company's privilege or freedom of choice is the very thing that was denounced in the Congressional hearings (this brief, p. 53). All the reasons for the

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manner, or upon the expiration of its period of corporate existence, the directors at the time of the dissolution shall be the trustees of the creditors and stockholders of the corporation * * *." 16 Fletcher, *Corporations* (Perm. Ed.), Sec. 8174.

[35] I.R.C. Sec. 141 permits a change to consolidated returns at any time. The choice of consolidated returns, once made, is a commitment to continue with them, unless because of material amendments to the regulations, or for other reasons, the choice is reopened (Sec. 141(b); Regs. 110, Sec. 33.11; Regs. 104, Sec. 23.11).

general rule are opposed to a claim predicated on the supposition that a choice under the revenue act gives to any party to the returns a right to demand a price for his consent or to exact a payment in lieu of taxes.[36]

This is especially true where, as here, the supposed bargaining power is to be employed against the reorganization court and its trustees. The Corporation caused its subsidiary to petition for reorganization, and

> "As a result of the filing of the petition in this case, the court, not the stockholders, acquired exclusive dominion and control over the estate. Hence, any strategic position occupied by the stockholders prior to these proceedings vanished once the court invoked its jurisdiction. Threats by stockholders of the kind here in question are merely threats to the jurisdiction of the court, which jurisdiction these selfsame stockholders invoked for their benefit when they caused the debtor's petition to be filed. Consequently, these claims of the stockholders are, as we have said, entitled to no more dignity than any claim based on their nuisance value."
> (*Case v. Los Angeles Lumber Co.*, 308 U.S. 106, 130-1.)

This means that in the circumstances of this case the holding company could not secure from the reorganization court a price for its signature. Petitioners' insistence on the supposed freedom of the holding company to file separate returns serves only to expose the fallacy on which their claim is based.

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[36] A contrary ruling would produce the absurd result of every group member claiming a price for his consent, a contest in which the member least concerned would hold the highest cards.

D. PETITIONERS HAVE NO CASE UNDER THE RULES OF LAW THEY INVOKE.

There is nothing to support petitioners' claim in the elementary principles which they invoke.

The claim fails because nothing belonging to the Corporation was taken or used. The Corporation did not *contribute* the returns; all it did was sign them as under the law it was bound to do. In so doing it incurred no expense and gave up nothing. It did not forbear from separate returns: that choice was not available to it, either under the general rule, or under the circumstances of this case. The corporation was not the owner of a strategic position.

The petitioners do not accept this. All their arguments are based on the assumption that the power to determine the amount of the trustees' taxes was merchandise belonging to the Corporation and that its exercise in favor of lower taxes was a service which it furnished to the trustees. This mistaken assumption invalidates their appeal to the elementary principles they invoke.

Petitioners Have Suffered No Wrong and Proved No Damage.

Petitioners do not prove a cause of action. They have no title claim. The funds they seek came from shippers in exchange for transportation service. They have never belonged to petitioners. With no title to assert petitioners, as other litigants, must prove that they have been wronged and damaged. They prove neither. In 1943 the courts gave formal recognition to the financial truth that over the years the interest of the Corporation in the old company had become worthless. Congress authorized a tax calculation wherein the amount of the Corporation's loss was deducted from the income figures appearing in the returns. Returns thus prepared were filed and audited and the group liability

was compromised and satisfied. Nothing in this process constituted a wrong to petitioners. They suffered no tort; no contract was breached; no statutory right was infringed. Petitioners have, therefore, no standing in court. "The only injury of which plaintiffs may complain in a judicial tribunal is the invasion of some legal or equitable right." *Tilney v. City of Chicago*, 134 F.2d 682, cert. den. 320 U.S. 759.

Nor have petitioners been damaged. The Corporation paid no tax under the consolidated returns (Ex. P. 3A/B, 4A/B, 5A/B, R. 491, 492) just at it would have paid no tax under separate returns (R. 1552, 2040). The reference in the returns to the fact of its loss cost the Corporation nothing. The Corporation had no income (Ex. D. 40, R. 1504, 1552, 2040). It could not have used the loss itself[37] and it could not have sold it.[38] The Corporation has thus proved no damage and without proof of damage no litigant can recover. "The damages recovered by an injured party have always been limited to his 'actual damages'." *Connecticut Ry. Co. v. Palmer*, 305 U.S. 493, 504. "Wrong without damage or damage without wrong does not constitute a cause

[37]The consolidated returns and the refund claim applied only a portion of the stock loss against income of the reorganization trustees. From the balance of the loss amounting to more than $42,000,000 (Exs. D. 40, D. 52A), petitioners have not been able to derive any gain whatever—proof positive that no damage has been suffered.

[38]In *J. D. and A. B. Spreckels Co. v. Commissioner*, 41 B.T.A. 370, the taxpayer had acquired the stock of a subsidiary in order to take advantage of a tax loss which the subsidiary was about to realize. The loss was taken and the taxpayer sought to claim the loss as a deduction in a consolidated return. It was held that since the acquisition of the stock had no business purpose the loss could not be allowed.

of private action * * *." *Clark Oil Co. v. Phillips Petroleum Co.*, 148 F.2d 580, 582, cert. den. 326 U.S. 734.

Petitioners Have No Unjust Enrichment Claim.

The failure of the reorganization trustees to pay additional taxes was not, in contemplation of law, an enrichment. Even if it were, the enrichment was not unjust to petitioners and without proof of injustice *to them* petitioners cannot recover. Finally, where, as here, the defendant is not a wrongdoer unjust enrichment recovery can never exceed the actual loss to the plaintiff—in this case, nothing.

Respondents Were Not "Enriched."

If separate returns had been filed for the years in question, or if the statute had not given a deduction for the loss in consolidated returns, the trustees would have paid additional taxes. The difference is not an "enrichment." Congress passed a statute authorizing the consolidated returns and prescribed that the loss should be entered as a deduction. The resulting benefits, if they are to be so termed, ~~came~~ from the statute. Congress expects that the deductions provided for by the Revenue Acts will be taken. "The legal right of a taxpayer to decrease the amount of what otherwise would be his taxes, or altogether avoid them, by means which the law permits, cannot be doubted." *Gregory v. Helvering*, 293 U.S. 465, 469.[39]

Assuming an Enrichment, It Was Not Unjust to Petitioners.

Even assuming that a lawful calculation of taxes could be called an "enrichment," petitioners still have no claim.

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[39]For a criticism by the Securities and Exchange Commission of the entire concept of a "tax saving" see Appendix B, p. 10.

"The mere fact that a person benefits another is not of itself sufficient to require the other to make restitution therefor." *Restatement of Restitution,* Sec. 1, p. 13. "But, in order to establish unjust enrichment it is not enough merely to show one's retention of the benefit. The retention must also be unjust." *Bailis v. R.F.C.,* 128 F.2d 857, 859. To succeed, a plaintiff must prove injustice to him. The doctrine is a doctrine of restitution. The plaintiff must show that something was taken from him and that there is some recognized basis—fraud, mistake, duress, undue influence, illegality—for revoking the transfer.

One consequence is that in every windfall situation, such as petitioners claim this to be, the defendant prevails. In *Straube v. Bowling Green Gas Co.,* 360 Mo. 132, 227 S.W. 2d 666, plaintiffs paid for gas at rates based upon charges made to the gas company by its suppliers. During litigation over the validity of an order reducing the rates of the supplier the difference between the new and the old rates was impounded and later paid to the gas company. Plaintiffs' unjust enrichment argument failed. "Since the facts alleged show no 'unjust privation' of appellants and no legal or equitable rights in appellants as to either fund, there could be no 'unjust enrichment' of respondent at the expense and loss of appellants." (227 S.W.2d 671). Other rulings to this effect are noted in the margin.[40]

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[40] In *Houck v. Hubbard Milling Co.,* 140 Minn. 186, 167 N.W. 1038, the defendant received refunds resulting from revision of freight rates. Plaintiff, who had made sales to defendant on the assumption the existing rates were to apply, attempted to claim the refunds. "The refunds amount to a find for the defendant. * * * No legal equity puts a right of recovery in the plaintiff." (167 N.W. 1039). In *Consolidated Cut Stone Co. v. Seidenbach,* 189 Okla. 128, 114 P.2d 480, subcontractors gave the owner certain credits on account of defaults of the general contractor. A surety

The cases make it clear that a windfall to respondents vests no claim in petitioners unless they can demonstrate injustice to them by an invasion of rights which the law recognizes. The rights of petitioners have not been invaded.

Petitioners' Unjust Enrichment Recovery Could Not in Any Event Exceed the Actual Loss to Them.

The law of unjust enrichment recognizes three situations: (a) that in which the defendant is free from fault; (b) that in which the conduct of defendant is tortious; and (c) that in which the defendant is a conscious wrongdoer. If the defendant is free from fault, the judgment, assuming a case is made out, is limited to the loss to the plaintiff or the benefit to defendant, *whichever is lower.* "If the [defendant] was no more at fault than the claimant, he is not required to pay for losses in excess of benefits received by him and *he is per-*

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later compensated the owner for the same defaults. The subcontractors, arguing unjust enrichment, attempted without success to obtain judgment in the amount of the credits. "Unless these appellants had rights existing prior to or at the time payment was made * * * which were violated or altered by the payment, the mere fact of excess payment can give them no right." (114 P.2d 484). In *Greek Catholic Congregation of Borough of Olyphant v. Plummer, et al.*, 347 Pa. 351, 32 A.2d 299, plaintiffs failed to recover from defendant royalties which defendants had received on coal which belonged to plaintiffs. "In every case of 'unjust enrichment' the courts have been able to point out some wrong done by the party enriched. By 'wrong' is meant, of course, the violation of another's legal right." (32 A.2d 300). In *Russo v. Hosmer, Inc.*, 312 Mass. 231, 44 N.E.2d 641, Hosmer was paid by Massachusetts for work he had illegally contracted to Russo who sought relief in quantum meruit. Russo's claim was denied. "He [Russo] was not damaged nor affected by the failure to observe the provisions in Hosmer's contract with the Commonwealth governing the subletting of the work." (44 N.E.2d 644). In *Vanderbilt University v. Williams,* 152 Tenn. 264, 280 S.W. 689, defendant received rent for land over which he and plaintiff had identical easements which entitled neither to rent payments. Plaintiff's claim for half of the rent was denied: "Equity may not be invoked to supply a remedy until a right, legal or equitable, exists." (280 S.W. 692).

mitted to retain gains which result from his dealing with the property." (*Restatement of Restitution,* p. 596 and see the illustrations, pp. 356 and 618.)

The cases agree. A surety, for example, who pays an obligation of his principal at a cost to the surety less than the obligation discharged can recover only his outlay. If, for instance, he pays the principal's debt in depreciated currency, he recovers only the cost of the currency to him.[41]

If, therefore, petitioners' case rests upon unjust enrichment, they cannot recover because they suffered no loss. Plainly there was nothing wrongful in the handling of the tax transaction. The Internal Revenue Code provides for consolidated returns; the stock loss deduction is within the plain language of Section 23(g)(4); liabilities within the group were determined in accordance with the formula universally recommended and which the parties had followed for twenty years. Taxpayers who follow twenty years of past practice and the unanimous precedents are not conscious wrongdoers or tort feasors. Unjust enrichment recovery could not, therefore, exceed in any event the gain to respondents or the loss to petitioners, *whichever is lower.*

Petitioners Have No Claim Arising from Fiduciary Obligations.

Petitioners attempt to support their position by contending that fiduciary obligations were operating in favor of the Corporation in connection with the tax transactions. The

[41]See, for example; *Bonney v. Seely,* 2 Wend. 481 (N.Y.): "If the plaintiff had paid the defendants' debt by paying half the amount, can he recover the whole from the defendants? I think not. He is entitled to recover the amount paid, not the amount extinguished by that payment." See also *Kendrick v. Forney,* 22 Gratt. 748 (Va.); *Butler v. Butler's Administrator,* 8 W. Va. 674; *Succession of Dinkgrave,* 31 La. Ann. 703; *Hall v. Creswell,* 12 Gill & Johnson 26 (Md.).

argument is unsound. In those transactions the Corporation was itself charged with fiduciary duties and its position was in no respect that of a *cestui que trust.*

The Corporation was charged with fiduciary obligations, *Consolidated Rock Products Co. v. DuBois,* 312 U. S. 510, 522, 524, and was obliged to cooperate to reduce the trustees' taxes (this brief, pp. 65-9).

The Position of the Corporation Was Not That of a Cestui Que Trust.

Petitioners seek to reverse the fiduciary obligations imposed by law and place the Corporation in the position of a *cestui que trust* by an attack upon the Corporation personnel who handled the tax transactions.

This attack fails because the record does not support it. The Corporation's officers and directors were active in looking after its interests and were competent and informed (this brief, pp. 8-9, 16-17).

Petitioners attack the tax attorney's work but they have no criticism of the returns or of his conduct of the transaction *vis á vis* the Bureau. His work was devoted to bringing about the least taxes required by law. They commend this work unreservedly (R. 1422-3). Their only complaint is that he did not tell the Corporation it had a strategic position. As to this, they say he did not advise them of their "right" to file separate returns. Actually, he did point out that this alternative existed under the statute and recommended against it because it would result in higher taxes (this brief, p. 11). They also complain that he informed them belatedly of the 1947 settlement proposal, but he gave them full information about it several months before the settlement was effected, and they had adequate time to act (this brief, p. 15).

These criticisms are reflections on the Corporation, not on the attorney. They reflect the true character of the petitioners' claim, and show again that it is a claim of power to force a payment as the price of "co-operation." This is strikingly exposed by the testimony that the Corporation's directors in 1947 would have used their "strategic" position to force a release from the bar of reorganization (R. 1007-8). In this they were unsuccessful (R. 168-70).

F ..thermore, neither incompetence nor control of Corporation personnel would either relieve the Corporation of its fiduciary obligations or impose fiduciary duties on others in the Corporation's favor. A fiduciary cannot avoid his responsibilities by lack of capacity. Nor can he, by complaining of his disability, impose those responsibilities on others. The Corporation as holding company, as a member of the affiliated group, and as petitioner for the reorganization of its subsidiary, had fiduciary duties in the tax transactions. Those duties bound the Corporation whoever its officers and directors might be. They were binding, moreover, on anyone who took charge of or participated in the tax transactions. Even if it were the fact, which it is not, that the trustees or their lawyers took charge of tax matters, the consequence would be only that the trustees and their lawyers, to the extent they acted for the Corporation, would be obligated to honor the fiduciary duties of the Corporation.

Those fiduciary duties, moreover, are not defined, as petitioners seem to believe, by the rules which apply to formal trusts. Fiduciary obligations in connection with corporate affairs are those which are appropriate for that purpose. They are not those which relate to express trusts. *Manu-*

facturers Trust Co. v. Becker, 338 U.S. 304, 311.[42] As far as consolidated returns are concerned they are best defined by the past practice of the group and all the precedents, all of which are in accordance with what was done and opposed to what petitioners claim should have been done.

Nothing which occurred in connection with taxes relieved the Corporation of its normal fiduciary duties to its subsidiaries and their creditors. Nothing imposed fiduciary duties on those subsidiaries in favor of the Corporation. The position of the Corporation was in no sense the position of *cestui que trust*. There was no trust, no trust *res*, and no trust obligation running to the Corporation. A discussion of fiduciary duties in this case serves only to support the judgment below.

Petitioners Have No Claim on Account of Duality.

The petitioners emphasize that the Corporation officers who handled the tax transaction were also employed by the trustees.[43] This duality is of no assistance to petitioners. Where significant duality exists, courts will examine a transaction in which the properties or interests of the complainant were taken or used. The examination is made to find out if the complainant received fair value for its properties or interests. Here nothing belonging to the Corpora-

[42]Compare *Securities and Exchange Commission v. Chenery Corp.*, 318 U.S. 80, 85: "But to say that a man is a fiduciary only begins analysis; it gives direction to further inquiry. To whom is he a fiduciary? What obligations does he owe as a fiduciary? In what respect has he failed to discharge these obligations? And what are the consequences of his deviation from duty?"

[43]The petitioners insist on a species of misrepresentation by ascribing the dualities to respondent, the reorganized company. The fact is the dualities ended with revestment, this brief, pp. 17-18).

tion was taken or used. There is, therefore, nothing to consider or evaluate.

Duality as such proves nothing. It creates no right. Its existence does not constitute a wrong. "It is not mere existence of an opportunity to do wrong that brings the rule into play; it is the unconscionable use of the opportunity * * *." *Comstock v. Group of Institutional Investors*, 335 U.S. 211, 229; *Leavenworth County Commissioners v. Chicago, Rock Island & Pacific Ry. Co.*, 134 U.S. 688, 705. Petitioners do not prove a claim by an appeal to a general doctrine of "fairness" unsupported by proof that any asset belonging to them was taken or used.

In the cases on which petitioners rely the courts received proofs of the value of the properties. There was in the record evidence of the market value, *Geddes v. Anaconda Mining Co.*, 254 U.S. 590, 600-02, or some other established guide to fairness, *Espach v. Nassau & Suffolk Lighting Co.*, 177 Misc. 521, 31 N.Y.S.2d 259, 264-5, aff'd *sub nom. Chelrob, Inc. v. Barrett*, 293 N.Y. 442, 57 N.E.2d 825, to which the court could turn. Petitioners offer nothing. This is understandable; the "property" they claim, the strategic position, was not theirs to deal with as an asset or a service.

Moreover, the duality doctrine is particularly inapplicable here, for several reasons:

First: The Corporation cannot complain of a duality which it created for its own purposes. *Myers v. Louisiana & A. Ry. Co.*, 7 F. Supp. 97, 99; *Rosaly v. Gonzales*, 106 F.2d 169, 172.

Second. Duality between the Corporation and the officers of the reorganization court is of no significance. The pay from the reorganization trustees did not impose an obli-

gation on the officers of the Corporation inconsistent with their obligations to their company. The trustees had no personal interest in the reorganization. *In re Ducker*, 134 Fed. 43. Their only purpose was to see that all approved claims were paid. There was, therefore, none of the conflict of interest upon which the duality rule depends. "Here we are dealing with officers of the court and directors appointed by them, men of standing, ability and integrity. There is here no room for any reaction of prejudice or bias, conscious or otherwise, to the frailties of human nature * * *" *J. C. F. Holding Corp. v. General Gas & Electric Corp.*, 181 Misc. 283, 46 N.Y.S.2d 605, 611. Moreover, the Bankruptcy Rules themselves demonstrate that duality in connection with a reorganization proceeding is not a significant circumstance. Section 77 (11 U.S.C. Sec. 205) authorizes it and General Order 44 contains a special provision authorizing the court in a railroad reorganization proceeding to employ attorneys associated with the debtor. Duality does not affect the course or finality of a reorganization proceeding. *Duryee v. Erie R. Co.*, 175 F.2d 58, cert. den. 338 U.S. 861.

Third. The duality cases do not criticize a transaction conducted in accordance with what prudent and independent persons would have done under the circumstances, *Hellier v. Baush Machine Tool Co.*, 21 F.2d 705, 707; *International Radio Telegraph Co. v. Atlantic Communication Co.*, 290 Fed. 698, 702, without benefit of hindsight. *Blaustein v. Pan American Petroleum & Transport Co.*, 293 N.Y. 281, 56 N.E.2d 705, 715; *Crawford v. Mexican Petroleum Co. of Delaware*, 130 F.2d 359, 362. The tax transaction was handled in strict accordance with twenty years of past practice of the group, with the general practice of the business

community and with all the relevant precedents. Presumably, therefore, any prudent person would have done precisely what was done. The courts will not interfere. *Hellier v. Baush Machine Tool Co.*, supra; *International Radio Telegraph Co. v. Atlantic Communication Co.*, supra.

Petitioners Have No Claim Based on a Hypothetical Bargain.

Interveners argue in effect that this Court should make a retrospective bargain between the reorganization trustees and the Corporation and enforce it against respondents. This asks the impossible.

First. This Court has no power to exercise bankruptcy jurisdiction to make a bargain for petitioners. The reorganization trustees are not parties to this proceeding and cannot be made parties. The Court can hardly bargain for them in their absence. Moreover, jurisdiction over those trustees is vested not in this Court but in the bankruptcy court and the jurisdiction is exclusive. *U. S. Fidelity & Guaranty Co. v. Bray*, 225 U.S. 205, 217; *Isaacs v. Hobbs Tie & T. Co.*, 282 U. S. 734, 739.

Second. The reorganization court would have required the Corporation to sign the returns without a bargain for its "strategic position," *Case v. Los Angeles Lumber Co.*, 308 U. S. 106, 130-1. The Corporation was obliged to co-operate and could not bargain for the performance of its duty (this brief, pp. 64-9).

Third. Nothing turns on the supposed freedom to choose to file a separate return. The accepted rule against "tax saving" payments applies alike to cases in which there is a choice and to cases in which there is none (this brief, pp. 69-70).

There Has Been No Unfairness to Petitioners.

The duality doctrine, even if it has application here, goes no further than to say that the tax transactions should be fairly conducted. By every available standard there has been no unfairness to petitioners. What was done was in strict accordance with the past practice of the Western Pacific group, with the generally accepted business practice and with the uniform conclusion of the Securities and Exchange Commission, the Treasury Department, the Federal Trade Commission and all persons who have considered the problem. What better test could there be of "fairness"?

Indeed, if "fairness" is the test, it is petitioners who must fail. There is no "fairness" in the effort of the Corporation to repudiate for its selfish purposes the established practice of the group; nor in the demand of the Corporation for a payment from a transaction in which it was neither wronged nor damaged; nor in the attempt of the Corporation to substitute itself as tax collector; nor in the effort of the Corporation to deprive the group of the benefit of a tax deduction allowed by Congress; nor in permitting the Corporation to recover a $17,000,000 judgment against a reorganized company owned by the unpaid creditors of its subsidiary (and their successors in interest) to whom the Corporation owed fiduciary obligations; nor in allowing the Corporation, a party to the reorganization proceeding, to repudiate that proceeding retroactively and assert a claim relating to the reorganization period which was never presented to the reorganization court and which, if allowed, would frustrate the purpose of the reorganization; nor in permitting the Corporation to undermine the financial position of the reorganized company on the basis of an after-

thought claim presented too late and in the wrong forum. Fairness is opposed to a claim which, in final analysis, rests on the assertion of a right to payment for refraining from the use of a separate return. "Fairness" in this case is with the judgment below.

Petitioners' Authorities

The case on which petitioners chiefly rely, *Commercial Nat. Bank in Shreveport v. Parsons,* 144 F.2d 231,[44] demonstrates the distance by which they fail to support their claim.

The Old Bank, virtually insolvent, conveyed all its assets to the New Bank, which assumed the Old Bank's liabilities to creditors. The contract between the banks (which proved highly profitable to the New Bank) authorized the New Bank to administer Old Bank assets and collect from them an amount sufficient to indemnify it for the liabilities assumed. The remaining assets were to be reconveyed to the Old Bank or liquidated for the Old Bank's account. The litigation was a suit by the Old Bank for an accounting.

The assets conveyed to the New Bank included certain parcels of real property. The Louisiana statute taxing the capital stock of banks provided that the assessed value of the stock might be reduced by the assessed value of all real property owned by the bank. The new Bank reduced the tax on its capital stock by the value of the Old Bank's real property. The court held that in the accounting the Old Bank

[44] The several opinions of the Court of Appeals in the Shreveport Bank cases are reported at 144 F.2d 231, rehearing denied, 145 F.2d 191, cert. den. 323 U.S. 796; 176 F.2d 1004, rehearing denied, 177 F.2d 514; 189 F.2d 668. Opinions of the trial court are reported at 28 F. Supp. 927, 44 F. Supp. 5, 64 F. Supp. 888, 72 F. Supp. 961, 89 F. Supp. 976, and 90 F. Supp. 264.

was entitled to a credit for the tax advantage which came to the New Bank in this fashion.

The basis of decision was the relation between the parties established by the express agreement of liquidation. The court held that the New Bank was not entitled to deduct from the assessed value of its own capital stock the value of the real estate of the Old Bank which it held as liquidator because it was not the owner thereof. The court said, 144 F.2d 231 at p. 236:

> "The credit thus obtained by the New Bank was a profit derived from the *trust property* as effectively as if it had been paid that much in cash." (Emphasis added.)

This case has nothing in common with the *Shreveport* case. The reorganization trustees received no assets from the Corporation for purposes of liquidation; they had no express liquidating agreement with the Corporation; they held no trust estate with a duty to account to the Corporation for the proceeds of the trust.

A case more closely in point is *Hopkins v. Detrick*, 97 C.A.2d 50, 217 P.2d 78, in which a husband claimed a portion of tax refunds payable to the wife on the theory, apparently, that by joining in community property returns he "saved" taxes for the wife. The claim was rejected. See also, *Cooper v. Central Alloy Steel Corporation*, 43 Ohio App. 455, 183 N.E. 439, 444, in which a stockholder's complaint about a "tax saving" arising from a merger was rejected because the complainants "were not interested or concerned" since they were "deprived * * * of not one penny."

The cases cited by petitioners which deal with consolidated returns are either plainly irrelevant (see *Woolford Realty Co. v. Rose*, 286 U. S. 319, holding that losses suffered by a subsidiary in years prior to affiliation cannot be deducted in a consolidated return, and *Duke Power Co. v. Commissioner*, 44 F.2d 543, holding that a return filed by subsidiaries in which the parent did not join was not acceptable), or they support the traditional formula for intragroup settlements without "tax saving" payments. For instance, in *Helvering v. Morgan's, Inc.*, 293 U. S. 121, the court recognized the propriety of the early statutory formula apportioning the consolidated tax in accordance with net taxable incomes of the group members. No tax saving payment was made or suggested. In *Koppers Co.*, 8 T.C. 886, 11 T.C. 894 the intragroup settlement was again according to the established formula and again there was no intimation that tax saving payments were required—and this even though in the *Koppers* situation there was no "economic unity" within the group. See Moody's Industrial Manual 1941, p. 2598. *Bankers Trust Co. v. Florida East Coast Car Ferry Co.*, 92 F.2d 450, is no different. Certain subsidiaries there agreed that a cash refund owing to them for overpayment of taxes should be applied to pay the tax deficiency of another group member. The court recognized that this use of the refund otherwise payable in cash created a right in the contributing subsidiaries to a compensatory payment from the subsidiary whose taxes had been thus paid. Here the Corporation made no tax payment to the Government (R. 1306-07) and it was entitled to no refund. All taxes which were paid were paid by the trustees (R. 824, 826, 1306-07). In the unreported decision *In re Missouri*

Pacific Railroad Co., Docket No. 6935 (E.D. Mo. 1947)[15] a subsidiary by joining in the consolidated returns was faced with an actual cash loss in increased taxes. The group paid the subsidiary not the amount by which the loss benefited the group but rather the amount of actual damage to the subsidiary from the returns. The Corporation in this case had no actual damage and on the theory of this decision it has no claim.

Truncale v. Universal Pictures Co., 76 F. Supp. 465 merely illustrates the familiar rule that corporate directors are not allowed to profit at the expense of their corporation. The directors reduced their personal taxes by causing the corporation to forego certain tax deductions. This increased the tax of the corporation. The District Court denied a motion for summary judgment on the ground that the corporation might possibly recover the full amount of the profit to the directors since "Directors and other officers of a private corporation cannot either directly or indirectly * * * in any * * * transaction in which they are under a duty to guard the interests of the corporation make any profit for themselves or acquire any other personal benefit or advantage, * * *" (76 F. Supp. at 468). *Edwards v. Lee's Administrator*, 265 Ky. 418, 96 S.W.2d 1028, the Kentucky cave case, involves nothing more than a distribution of profits where the defendants "were guilty of repeated trespasses upon" plaintiff's cave property. "The proof likewise clearly indicates that the trespasses were wilful and not innocent." (96 S.W.2d at 1030).

Chelrob, Inc. v. Barrett, 293 N. Y. 442, 57 N.E.2d 825 says only this: that the courts, otherwise reluctant to review busi-

[15]The opinion and order are set out in Appendix C of this brief.

ness transactions, will, when significant duality appears, make certain that the transactions were fair. The fairness referred to is the fairness which the law requires: a recognition of the rights of the parties. In most cases the extent of those rights requires no discussion. On a sale of property, for example, no one denies that the seller is entitled to a fair price. The problem, as in the *Chelrob* case, is only to determine whether the price was fair.

The decisions cited by petitioners in no way support their claims.

E. THE CORPORATION CANNOT IN EQUITY DEPLETE THE ASSETS OF ITS FORMER SUBSIDIARY AT THE EXPENSE OF CREDITORS WHO WERE NOT PAID IN FULL.

This is a demand for $17,201,739 presented against a reorganized railroad by the former parent company. That company directed its former subsidiary to sell securities to the public. The purchasers of those securities are the stockholders (and their successors in interest) of the reorganized company. To these stockholders, as creditors of the old subsidiary, the petitioner Corporation owes fiduciary obligations. *Consolidated Rock Products Co. v. DuBois*, 312 U.S. 510, 522.

By the plan of reorganization the old bondholders became the present stockholders. The exchange of securities was made on the assumption that the preferred stock of the reorganized company would be worth $100 per share and the common stock $57 and $62 per share. *Western Pac. R. Co. Reorganization*, 233 I.C.C. 409, 417. Even on this basis the secured creditors of the old company were not paid in full. The securities issued to the A. C. James Company, the creditor holding the junior secured position, fell short of

paying that company's claim by $3,495,900 (R. 1222, 2021). With interest, that unpaid claim now amounts to more than $5,000,000.

This $5,000,000 does not measure, however, the amount by which the secured creditors were not paid. These creditors, now stockholders of the reorganized company, not only surrendered their first mortgage bonds for securities of an inferior grade (income bonds, preferred stock and common stock) but those inferior securities have not had the value which the plan assumed they would have. This Court is entitled to take judicial notice of the market values. *Insurance Group v. D. & R. G. W. R. Co.*, 329 U.S. 607, 617, n. 6. The range of market values is shown in Appendix D; rarely have they reached the values assumed by the plan. Petitioners now propose to further reduce the assets of these creditors, now stockholders, by $17,201,739. Nothing could be more inequitable. Nothing could be more inconsistent with the fiduciary obligation owing from the Corporation to those creditors. Nothing could more plainly violate the settled principle that creditors have an absolute priority over stockholders. *Northern Pacific Ry. v. Boyd*, 228 U.S. 482, 504; *Case v. Los Angeles Lumber Co.*, 308 U.S. 106, 129. Nothing could be more radically at odds with this Court's doctrine that the claim of a holding company in the reorganization of its subsidiary must, whatever its technical status, yield to the necessity of doing justice to the creditors of that subsidiary. *Taylor v. Standard Gas Co.*, 306 U.S. 307.

II. The Bar of Reorganization

Petitioners failed to present their claim to the reorganization court while it was open for the purpose and as a result it is barred by the reorganization.

If a proceeding under Section 77 (11 U.S.C. Sec. 205) is to be effective in rehabilitating the debtor two things are required.

First, the reorganization court must consider and act upon all possible claims which might be asserted against the reorganized company. Chunks of the problem are not left to other tribunals, *Gardner v. New Jersey*, 329 U.S. 565, 577. To accomplish this purpose Congress has provided that claims which are not provable in an ordinary bankruptcy can be presented in a reorganization, Sec. 77(b); *Gardner v. New Jersey*, 329 U.S. 565, 572; *Foust v. Munson SS Lines*, 299 U.S. 77, 82.

Second, the reorganization must put an end to all claims, so that the reorganized company shall not be hampered or perhaps overwhelmed with holdover obligations that defeat the prime object of the proceeding, and so that all persons dealing with it or in its securities may act in reliance upon the reorganization as definitive and settled.[46]

Petitioners propose to flout these settled purposes of a reorganization. They ask the Court to declare that the reorganized company did not emerge from the reorganization proceeding with its liabilities defined; that on the contrary and in spite of efforts extending over a period of eleven years by the Interstate Commerce Commission and the courts, the Company emerged from reorganization with an undefined and undisclosed liability of $17,201,739, a liability,

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[46]See the following: The Erie reorganization cases, *Duryee v. Erie R. Co.*, 175 F.2d 58 and *Beckley v. Erie R. Co.*, 175 F.2d 64; *McColgan v. Maier Brewing Co.*, 134 F.2d 385, cert. den. 320 U.S. 737; *Black v. Richfield Oil Corp.*, 146 F.2d 801, cert. den. 325 U.S. 867; *In re Colorado & S. R. Co.*, 84 F. Supp. 134, cert. den. 338 U.S. 847; *Standard Steel Works v. American Pipe & Steel Corp.*, 111 F.2d 1000; *North American Car Corp. v. Peerless W. & V. Mach. Corp.*, 143 F.2d 938; *In re Peyton Realty Co.*, 148 F.2d 771; *Mohonk Realty Corp. v. Wise Shoe Stores*, 111 F.2d 287.

moreover to be paid in cash by a reorganized company whose first mortgage bond issue was limited to $10,000,000 and which was permitted to have no other fixed interest charge. This suggestion, if accepted, would render ridiculous the efforts in the reorganization to define the liabilities of the new company.

A. THE CLAIM IS A CLAIM AGAINST THE TRUSTEES IN REORGANIZATION, AND IS INVALID BECAUSE IT HAS NEVER BEEN APPROVED BY THE REORGANIZATION COURT.

During 1942, 1943 and the first four months of 1944, the trustees earned large incomes from the railroad properties. The tax liability on these incomes was a liability of the trustees, *Reinecke v. Gardner,* 277 U.S. 239, and the tax, if any, was a cost or expense of administration, *Michigan v. Michigan Trust Co.,* 286 U.S. 334, 344. Petitioners' claim, based upon an alleged saving of these taxes, would, if paid, also have been a liability of the trustees and an expense of administration.[47]

As such, it was the concern of the bankruptcy court and was within its jurisdiction, Sec. 77(e); *Brown v. Gerdes,* 321 U.S. 178, 183-4.

The reorganization trustees, as court officers, had no power to incur any liability to the holding company for a "tax saving" payment or otherwise except by express authorization of the reorganization court. This is settled.

> "The receiver being an officer of the court, and acting under the court's direction and instructions, his powers are derived from and defined by the court

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[47] Cf. the Corporation's supplemental complaint (R. 208), alleging that the obligation to account for the tax savings and pay them to the holding company "was an obligation incurred by the Trustees in their operation of the debtor's estate" (R. 224).

under which he acts. He is not such a general agent as to have any implied power, and his authority to make expenditures and incur liabilities—like the one in question—must be either found in the order of his appointment, or be approved by the court, before they acquire validity, and have any binding force upon the trust."

(*Chicago Deposit Vault Co. v. McNulta*, 153 U.S. 554, 561.)[48]

This principle requiring court sanction to create a liability of the estate was approved by Congress for railroad reorganizations. Section 77(e) says that the reorganization plan must provide "*for the payment of all costs of administration and all other allowances made or to be made by the judge.*" And it was expressly recognized in the Western Pacific proceeding. The reorganization court authorized the debtor to continue its railroad business and provided:

> "The authority given by the foregoing shall not include authority to incur expense, other than such as is necessary in the course of the usual and ordinary maintenance and operation of the debtor's property. *Any extraordinary expense* and expense incident to reorganization of the debtor *shall be subject to the prior approval of the Court.*" (R. 1910) (Emphasis supplied.)

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[48]The rule is strictly applied. In *Northern Finance Corp. v. Burns*, 5 F.2d 11, a receiver without prior authority borrowed funds to pay taxes due from the estate. The claim of the lender for the amount of the loan was denied. In *Byrnes v. Missouri National Bank*, 7 F.2d 978, a receiver, authorized to borrow \$150,000, borrowed an additional \$2,000. A claim for the \$2,000 was disallowed. In *In re Erie Lumber Co.*, 150 Fed. 817, merchants furnished goods to a receiver who had no court authority to buy. They were denied compensation. In *Union Trust Co. v. Illinois Midland R. Co.*, 117 U.S. 434, this Court invalidated claims for \$54,000 and \$32,000 created by a receiver without prior court approval.

This provision was affirmed in the order appointing the reorganization trustees and transferring the railroad properties to them (R. 1187, 1923).

An unprecedented liability of $17,201,739 would certainly be an "extraordinary expense." As such, it could not be incurred without "the prior approval of the Court." No such approval was sought—or obtained. Accordingly, petitioners' claim never became a valid obligation of the trustees or the estate. To obtain strict judicial supervision of all expenses connected with a reorganization was one reason for substituting Section 77 for the traditional equity receivership. *Leiman v. Guttman*, 336 U. S. 1. The policy is extremely rigid—so much so that it has been extended to fees and allowances which are not to be paid from the assets of the estate. *Leiman v. Guttman*, supra. Petitioners ask the Court to repudiate this firm policy.

B. UNALLOWED CLAIMS FOR EXPENSES OF ADMINISTRATION WERE BARRED AND EXTINGUISHED IN THE WESTERN PACIFIC REORGANIZATION.

After the plan of reorganization had been confirmed, the bankruptcy court vested the property in the reorganized company, discharged the trustees, and made a final order terminating the proceedings and ending the reorganization. In all this the court followed the mandate of Section 77 and its orders have long since become final.

In the course of these proceedings the court effectually adjudicated that petitioners' claim was invalid and barred its assertion against the reorganized company. Such adjudication and bar are none the less effective because the claim is rejected *in toto*, *Gardner v. New Jersey*, 329 U.S. 565, 574,

or is denied recognition because of the failure to present it, *New York v. Irving Trust Co.*, 288 U. S. 329.

The adjudication and bar were perfected by the revestment order and the final order terminating the Western Pacific reorganization.

Long before March 15, 1944, the Corporation could have presented its claim to the bankruptcy court.[49] The revestment order was made November 27, 1944. Under its terms the reorganized company was required to assume only such unpaid expenses of administration as the bankruptcy court had theretofore approved or should thereafter approve[50] (R. 50).

In its order the court reserved jurisdiction to approve costs and expenses of administration after revestment. Thus the holding company had further time after revestment within which to present its claim.

Some fifteen months after revestment, the Court made its final order terminating the proceeding. This order operated as a termination of its reserved jurisdiction to approve expenses of administration and effectively closed the proceeding against the subsequent presentation of such claims.

The text of the orders leaves no room for doubt that the statutory mandate was executed.

The revestment order (R. 36, 498, 1711) vested the properties in the reorganized company

> "free and clear of all rights, claims, liens and interests of said Trustees, the former stockholders and creditors

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[49]March 15, 1944, was the date on which tentative consolidated returns for 1943 were filed. On petitioners' theory that the tax savings are referable to separate return tax computations beginning with the 1942 returns (this brief, p. 114), the date would have been December 31, 1942.

[50]Except tax liability to the United States for which court approval was not required; cf. Sec. 77(f) (11 U.S.C. Sec. 205(f)).

of the debtor, *and of all other persons, firms and corporations whatsoever,* except as otherwise provided in this order, * * *" (R. 51-2) (Emphasis supplied.)

This was a judgment *in rem* against the world pronounced by a court of competent jurisdiction, *Tilt v. Kelsey,* 207 U. S. 43, 54; *Local Loan Co. v. Hunt,* 292 U. S. 234, 241; and is *res judicata* against the holding company, which was a party to the proceeding, *Stoll v. Gottlieb,* 305 U. S. 165; *Chicot County District v. Baxter State Bank,* 308 U. S. 371.

The revestment order specified the obligations to be undertaken by the reorganized company. As respects costs and expenses of administration, paragraph 20 of the order provided that

> "this Court expressly reserves jurisdiction to determine all costs and expenses of administration"[51] (R. 62).

The effect of the revestment order is clear. It barred all claims against the reorganized company on account of costs and expenses of administration, other than those which had theretofore been approved or might thereafter be approved by the court under the jurisdiction reserved for the purpose.

The reorganization proceeding was not closed until March 28, 1946 (R. 1219, 2013), long after the last of the tax returns in issue here had been filed. Petitioners never took advantage of the opportunity to present their claim. Accordingly and in due course the court by its final order terminated the reorganization and permanently enjoined the as-

[51]Paragraph 20 is not limited to claims perfected before revestment. It contains no reference to any date. Petitioners are inadvertently mistaken in saying that the court did not reserve jurisdiction "to supervise claims arising after the revesting." (Corp. brief, p. 132).

the judgment must be presented for proof and allowance. *Thompson v. Texas Mexican R. Co.*, 328 U.S. 134, 144. When on March 28, 1946, that court barred all administration claims not theretofore allowed, the time for proof and allowance was gone.

8. Petitioners refer to *Callaway v. Benton*, 336 U.S. 132, and argue that the reorganization court was without power to order the holding company to join in the returns. We have shown that it had the power, and that *Callaway v. Benton* is not a holding *contra* (this brief, p. 66). In any event, the mooted want of power has no bearing on the finality of the orders in the reorganization proceeding.

9. Petitioners have not argued that duality takes their claim out of the bar, nor could they. A final judgment can be attacked collaterally only for want of judgment in the court that pronounced it, or upon a showing that the party attacking it was prevented by some fraud practised directly upon him from presenting his case to the court that pronounced the judgment, *United States v. Throckmorton*, 98 U.S. 61; *Stoll v. Gottlieb*, 305 U.S. 165. Nothing of the sort occurred here.

The holding company was a party to the proceeding, represented by Judge Sloss, formerly a Justice of the highest California court (R. 1599). No one questions his independence. The dualities could have been severed any time at the will of the holding company. They ended with revestment, fifteen months before the final order (this brief, p. 17). The Corporation's general counsel thought of the claim in 1944, but concluded after consulting expert tax lawyers that it had no value then, and spoke to no one about it (R. 1060-7). The dualities existing during trustee operations

were permitted by the statute (Sec. 77(c)(1)), the general orders (Order 44) and the court's order (R. 1187-91, 1923). If dualities thus authorized open the finality of railroad reorganizations to attack by holding companies which created the dualities, the purpose of the statute will be subverted.

E. THE REORGANIZATION BAR HAS SPECIAL MERIT AGAINST PETITIONERS.

The defense is meritorious, as applied to everyone, even those who have had no actual notice, whose claims are plain and just, and who have not presented them because of excusable ignorance or blameless misfortune.

Here the defense has special and overwhelming merit. The Corporation had complete notice, and was assiduous and persistent in pursuing its claims (R. 1051-2, 1056-64). Here it is not the notice of approaching bar and judgment that was lacking. The thing that was missing was presentation of the claim. General counsel for the holding company considered the claim and for reasons satisfactory to himself abandoned it (R. 1060-7). The actors in the transaction, namely, the court, the trustees, and the officers who filed the returns, acted in the belief that the tax reduction was the trustees' concern.

We submit that Section 77 does not sanction but forbids the survival of such a claim.

III. The Defenses of Limitations, Laches and Estoppel

The claim for 1943 is barred by the statute of limitations. The 1943 returns took advantage of the loss of the Corporation (Exs. P. 4A/B, R. 491, D. 40, R. 1517). They were filed July 15, 1944 (Ex. P. 4A/B). This action was filed more than two years thereafter (R. 5). California law de-

sertion by petitioners or anyone else of any such claim as here presented (R. 1219, 2017-18).

The final order terminated the proceedings. It operated as a termination of reservations of jurisdiction[52] and ended the reorganization. No appeal having been taken, it is now conclusive and operates as a bar and as *res judicata* upon petitioners' claim.

The Assumption Agreement Does Not Provide for Payment of the Holding Company's Claim.

At this point we stop to examine petitioners' contention that by the assumption agreement the reorganized company assumed the liability of the trustees for their "tax savings."

The assumption agreement is an exhibit to the revestment order, and is one of the instruments which, by that order, the reorganized company was directed to execute. Its text appears at R. 76-81.

The particular clause on which petitioners rely reads as follows:

> "2. Assume * * * any and all liabilities and obligations with respect to claims of any character whether heretofore or hereafter asserted arising out of the possession, use or operation of the debtor's properties by said Trustees, or their conduct of the debtor's business, * * *" (R. 78)

Since all assets of the estate were to be transferred to the new company, some provision had to be made to find funds for the actual payment of the approved and outstanding obligations of the trustees. Under such circumstances it is conventional for the new company to provide the funds

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[52] Except those reserved in the final order, which have no application here.

required to pay the trustees' recognized debts and the reorganization court directed the execution of an agreement so providing. The language was broad in order to give the trustees full protection against personal liabilities after they had completed their duties and received their discharge. Petitioners contended in the courts below that the obligation to make "tax savings" payments was "an obligation incurred by the Trustees in their operation of the debtor's estate and was an obligation assumed by the defendant * * *" (Supp. Compl. par. Eleventh, R. 224). They argued in their trial briefs that the assumption agreement relieved them of the necessity of presenting their claim to the reorganization court. The suggestion is not repeated. In any event, it has no validity. There are many reasons.

First. The purpose of the assumption agreement was to provide money for the discharge of recognized debts and to provide the trustees with personal protection. It was not to undo all the work of the reorganization by giving validity to an undisclosed claim for $17,201,739.

Second. The reorganization court, in directing the execution of the assumption agreement, did not eliminate the necessity that expenses of administration be approved by the court. On the contrary it expressly reaffirmed that requirement in Paragraphs 10 and 20 of the revestment order (R. 50-1, 61-2). It is incredible that the court, which from the beginning had forbidden its trustees to incur any extraordinary expense without its approval (this brief, p. 92), should have intended to saddle any such unapproved expense on the new company.

Third. Petitioners' argument is, in effect, that the reorganized company agreed to assume and discharge *all* obliga-

tions of the trustees. The reorganization court made it clear, however, that the assumption agreement should not be so understood. In directing the execution of the agreement the Court described it as follows:

> "(a) agreement providing for the assumption of *certain* obligations, liabilities, contracts, agreements and leases of the debtor and the debtor's Trustees, * * *" (R. 46).

and went on to say:

> "* * * and said Railroad Company shall assume only the valid and outstanding obligations and liabilities of the debtor or the debtor's trustees * * *" (R. 50).

The references in the order to "*certain* obligations" of the trustees and to "the *valid* and *outstanding* obligations" of the trustees make it clear that it was never intended that the assumption agreement should obligate the reorganized company to pay *all* obligations of the trustees.

Fourth. Assumption presupposes an obligation to be assumed. Since the result of petitioners' failure to obtain court approval of their claim is that the claim never became an obligation of the trustees (this brief, pp. 91-3), petitioners could not recover even if the assumption agreement were construed to refer to all trustee obligations.

Fifth. The reorganization court had no power and it did not intend by the assumption agreement to eliminate the requirement of Section 77(e) that costs of administration be approved by the court.

An assumption agreement in a reorganization proceeding has a limited and well understood purpose. It operates within and not beyond the framework of the reorganization.

It does not give validity to claims otherwise invalid or give vitality to claims which have been barred..

We return to our argument.

C. THE REORGANIZATION BAR IS FINAL AND CAN NEITHER BE OPENED NOR AVOIDED.

The reorganization is a complete and insurmountable bar to any recovery by petitioners in this action. It is a bar because the survival of claims that have not been brought to the reorganization court's notice is contrary to Section 77. It is a bar because of the settled rule that a claim for payment of an expense of administration which is not allowed by the court in charge of the estate has no validity. It is a bar because the reorganization court by specific decree has vested the property in the reorganized company free and clear of unallowed claims and has enjoined the assertion of any such claim.

Petitioners' failure to present their "tax saving" claim in the reorganization proceedings also bars the claim under principles of *res judicata*. The order vesting the property in the reorganized company free and clear of all administration claims not allowed by the court, i.e., free and clear of petitioners' claim, is a judgment that extinguished the petitioners' claim when the final order was made.[53] A litigant who asserts claims against an estate in the hands of a court must in the first proceeding assert all of his claims or be forever foreclosed. *United States v. California & Ore. Land Co.*, 192 U. S. 355; *Northern Pacific Railway Co. v. Slaght*, 205 U. S. 122; *Montezuma Canal v. Smithville Canal*, 218

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[53]By virtue of its terms the revestment order barring unallowed claims did not operate to bar claims thereafter allowed under the reserved jurisdiction.

U.S. 371; *Estate of Bell,* 153 Cal. 331, 95 Pac. 372; *Krier v. Krier,* 28 C.2d 841, 172 P.2d 681.

D. REPLY TO PETITIONERS' CONTENTIONS.

We turn to the arguments by which petitioners seek to open or to avoid the bar, beginning with those which were considered in the dissenting opinion in the Court of Appeals.

1. In its supplemental complaint the holding company applies for a modification of the final order (R. 229-30). The law is settled against this suggestion. This is a suit in equity. It is not a proceeding in the bankruptcy court. *Naylor v. Cantley,* 96 F.2d 761, 763. The court sitting in equity cannot modify a bankruptcy order. *In re Watts and Sachs,* 190 U. S. 1, 27; *Isaacs v. Hobbs Tie & T. Co.,* 282 U. S. 734, 739. The petitioners' application for modification must be denied for want of jurisdiction to entertain it. The courts below and this Court are bound to accord to the bankruptcy orders the force of final bars and judgments.

2. Petitioners suggest that they have an independent claim against the new company as to the tax savings for 1942 and the first four months of 1944. But no matter how it is stated, the claim is based upon an alleged contribution to the reduction of the trustees' taxes, and that claim has been disallowed.[54] The final order in reorganization was an effective disallowance and is binding upon the Corporation and upon the reorganized railroad company.

Moreover, petitioners predicate their claim on events which took place during trustee operations, an appropriation of the holding company's loss in the returns filed July

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[54] *Seaboard Air Line R. Co. v. Savannah Union Station Co.,* 181 F.2d 267, cited by the Corporation (its brief, p. 131), did not involve a claim for an expense of administration.

15, 1944, and on dualities which terminated with the end of trustee operations. Petitioners thus relate their claim to the period of trustee operation.

In support of their argument petitioners refer to the fact that the returns for the first four months of 1944 were not filed until March 15, 1945,[55] that is to say, after revestment, and that the holding company filed the claim for refund of 1942 taxes on March 9, 1945. They contend that these were acts done to assist the new company, not the trustees. The distinction has no substance. The acts were performed to reduce the trustees' taxes, and the claim for compensation was, of course, a claim to a cost of administration. Under the mandate of the statute and the orders of the reorganization court, the claim could not have validity nor become a charge against the new company, without the approval of the reorganization court.

Petitioners, and the dissenting judge, also suggest that a new claim arose after the final order in reorganization was made. In the dissenting opinion it is said that the holding company

> "at the request of defendant long after the reorganization had been closed, entered into a settlement with the United States, whereby its losses were used to obtain a benefit of $17,000,000 for defendant." (R. 2247)

The opinion suggests that this was co-operation which gave rise to a new *quantum meruit* claim against the new

[55] The date the tentative returns were filed; final returns were filed June 15, 1945. The consents to the returns so filed, though executed in the name of the reorganized company, were the trustees' consents, I.R.C. Sec. 52, Treas. Regs. 104, Sec. 23.15(b), G.C.M. 12208, Cum. Bull. XII-2, p. 87; 415 South Taylor Building Corp., 2 T.C. 184.

company. This action was then pending, so that the "co-operation" could hardly be more than a joint act by which, without either adversary giving aid or comfort to his opponent in the controversy between them, the subject matter in controversy was realized.[56] Moreover, an express agreement on the subject of the settlement was made between the Corporation and the new railroad company. This was the stipulation (R. 492, 1658) wherein it was agreed that the settlement should not prejudice the claims or defenses of the opposing parties,[57] except to the extent that it operated to reduce the amount of the tax savings in controversy. The stipulation was, of course, voluntary. No *quantum meruit* claim can be predicated on co-operative acts performed under an express agreement, *Restatement of Restitution*, Sec. 107; *Ullman v. May*, 147 Ohio 468, 72 N.E. 2d 63.

Petitioners also suggest that their claim did not mature until 1947, but this, if correct, did not prevent its presentation in the reorganization while it was contingent, *City Bank v. Irving Trust Co.*, 299 U.S. 433; *Brown v. Gerdes*, 321 U.S. 178, 181. The dissenting opinion characterizes the right claimed by petitioners, namely, the alleged right to file returns of its own choice, as a right appurtenant to the stock, which accrued before the returns were filed. A

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[56] The Corporation understood this. Its directors considered rejection of the settlement unless respondents would waive their defenses of the reorganization bar and the statute of limitations (R. 1007-8).

[57] The acceptance of the settlement with the Government "shall be without prejudice to the interests, claims or defenses asserted by the parties," and "none of the parties waives any of its interests, claims or defenses," and nothing in the stipulation is "a recognition or admission * * * of the validity, merit or equity of the claims," or a waiver of defenses "in any manner or to any extent" (R. 1659-60).

claim of this right and for compensation on account of its exercise was presentable to the reorganization court before the returns were filed. The holding company had the necessary information as early as May, 1943, nearly three years before the final order was made (R. 591, 1757).

3. Petitioners contend, and the dissent seems to agree, that Section 77 proceedings bar only claims against the debtor, i.e., claims existing at the time the petition is filed. They suggest that administration claims remain at large, so that a field day of litigation over unpresented claims is permitted in all the courts after the reorganization is completed. We have answered this (this brief, pp. 91-6). In support of this contention they refer to *Texas and Pacific Railway Co. v. Johnson*, 151 U.S. 81, and *Texas and Pacific Railway Co. v. Bloom*, 164 U.S. 636. These cases arose out of a single railroad receivership in which it was held that the railroad company was responsible for the receiver's debts. The decisions are readily explained by the fact that the proceeding was a friendly one and the properties were returned to the company without any reorganization taking place.

Petitioners suggest some further arguments which are not mentioned in the dissenting opinion.

4. It is argued that a recovery by petitioners would not impair the plan of reorganization, and that the plan did not contemplate the increase in the estate which resulted from the trustees' tax savings (Corp. brief, pp. 49-56, Int. brief, pp. 90-2). The argument is incorrect in this, that the plan intended the secured creditors to have the chance of gain as well as the risk of loss attendant upon the enforced reduction of their secured claims to junior securi-

ties. *D. & R. G. W. Co. v. Reconstruction Finance Corporation,* 328 U.S. 495, 517, 522. It is immaterial to the bar of reorganization whether or not the plan would be frustrated (as plainly it would in fact) if the Corporation should obtain a $17,201,739 judgment. Unallowed administration claims were barred and extinguished. This was prescribed by Section 77, and nothing in the plan requires, or could require, a different conclusion.

5. It was suggested on brief below that by its order approving the reserve fund for contingent tax liability, the Court imposed on its trustees an obligation to account to the holding company for the use of the loss. Obviously the Court had no such intention; its purpose was to approve the reserve fund for contingent tax liability to the United States Government, and manifestly the court considered the potential tax reduction was for the trustees' advantage, not the corporation's (R. 1270-4, 2023). The argument is, in effect, that the Court's implied approval of the returns as beneficial to the bankruptcy estate was an order approving the holding company's claim to the benefit though the Court intended otherwise. The statute and the Court's orders required that administration claims be approved by the Court. The requirement is not satisfied by an order that was made without notice of the claim and that displayed a purpose inconsistent with it.

6. Petitioners say they were not given notice to present their claim. But they had notice: the holding company was a party to the proceeding; the statute and the revestment order gave notice of the necessity for Court approval; and fifteen months after revestment, and three years after the claim was presentable, was adequate time to present the

claim. Moreover, as a party to the proceeding, the Corporation did receive notice of the petition for the final order and also received notice that it had been made (R. 109, 1218, 2011). The statute required no further notice and authorized the final order upon the notice that was given. Cf. *Hanover National Bank v. Moyses*, 186 U.S. 181, 182; *Mohonk Realty Corp. v. Wise Shoe Stores*, 111 F.2d 287, 290.

7. Petitioners suggested on briefs below that the holding company might have sued the trustees in another court under the authority of 28 U.S.C. Sec. 959, and *Thompson v. Texas Mexican R. Co.*, 328 U.S. 134, was cited. The statute (formerly Judicial Code Sec. 66) authorizes suits against court trustees without leave of the court that has appointed them. The suggestion does not reach the bar nor affect the finality of the judgment in reorganization. The trustees were discharged seventeen months before this suit was filed, and are not parties, so that this is not a suit under the statute and no suit could have been maintained under the statute after they were discharged. But the reorganization court was open to hear the claim for ten months after the discharge of the trustees. Moreover, since in this suit the petitioners seek modification of the final order (R. 229-30)[58] and the claim is founded upon complaints concerning conduct and dualities in the administration of the estate, it is apparent that it is not a case which the statute permits to be brought outside the bankruptcy court. Cf. *U. S. Fidelity and Guaranty Co. v. Bray*, 225 U.S. 205, 217. Finally all cases under the statute lead to the reorganization court, to which

[58]Even in the bankruptcy court, the order could not be modified without being preceded by an order reopening the reorganization. *Mohonk Realty Corp. v. Wise Shoe Stores*, 111 F.2d 287; *In re Peyton Realty Co.*, 148 F.2d 771.

visional the decisions of the court in 98 per cent or more of the cases that come before it. On petition of a dissatisfied party its decisions would automatically be subject to a species of horizontal appeal which would completely nullify the prime statutory objective of effecting a division of the court's work." (R. 2295)

Judge Pope states that this was his reason for joining in the opinion below:

> "As I understand the majority opinion, it went no further than to hold that a disappointed litigant in the position of the appellant in that case, could not, by filing a petition for rehearing in banc, require all the judges of the court to consider and pass upon that petition. I concurred in that opinion because in my mind a contrary holding would mean that the court would, as a practical matter, lose the opportunity which it now has to expedite its disposition of cases through the hearing of matters before divisions."
> (*Bradley Mining Co. v. Boice*, 198 F.2d 790, 791, n. 2.)

So the established practice in the Ninth Circuit is that, in the absence of an order by a majority of the acting circuit judges for a rehearing in banc,[64] the original order assigning the appeal to a division stands and, that being so, the petition for a rehearing is in law addressed to it and will be passed upon by it. What the opinion makes clear is

[64]The majority clearly were not holding that they were without power to order a rehearing in banc, for they expressly ruled that the composition of the court in any particular case is an administrative and intramural matter for the court alone to determine (R. 2295). They further held, in passing upon and denying petitioners' motion for leave to file a motion to vacate the order striking their petition for a rehearing in banc, that in this instance they did not want to take the case out of the hands of the division to which, by prior order, it was regularly assigned. Clearly, they had the right to decide that they would not interfere with the original assignment. This being so, petitioners were not aggrieved by the striking of their petition for a rehearing in banc.

that the Ninth Circuit has no rule or practice giving a party who has lost its appeal the right to petition the rest of the court for a rehearing.[65] Certainly the court is entitled to protect itself against having to re-do the work of its divisions at the behest of each disappointed litigant.

CONCLUSION

It is respectfully submitted that the judgment below should be affirmed with costs to the respondents.

Dated: December 5, 1952.

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[65]Petitioners suggest (Corp. brief, pp. 152-4) that because a majority of the active circuit judges have the power to order a rehearing in banc a dissatisfied litigant has the right to petition for a rehearing in banc, including the right to have at least a majority of the active circuit judges entertain and pass upon such a petition. This, as we have shown, is not so. If the Ninth Circuit were to adopt a formal rule that petitions for rehearing in banc will not be entertained or granted unless a majority of the division that originally heard the appeal so request and a majority of the active circuit judges concur, such a rule would clearly be valid. (Cf: Rule 33 of this Court.) This, in effect, is the practice in the Ninth Circuit, as is made clear by the opinion of six of the seven active circuit judges (R. 2288) and if a rule would be valid the equivalent practice is equally valid. This practice is none the less valid because a different practice prevails in the Third Circuit and in the Court of Appeals for the District of Columbia.

cides the applicable period of limitation, *Guaranty Trust Co. v. York*, 326 U.S. 99; and since this is an unjust enrichment claim the two-year statute, Sec. 339, Subd. 1, California Code of Civil Procedure, is applicable. *Richter v. Henningsan*, 110 Cal. 530, 537, 42 Pac. 1077, 1079; *Bray v. Cohn*, 7 Cal. App. 124, 93 Pac. 893; *Trower v. San Francisco*, 157 Cal. 762, 767, 769, 109 Pac. 617, 619, 620; *Jacobson v. Mead*, 12 C.A.2d 75, 81, 55 P.2d 285, 288; *Lazzarevich v. Lazzarevich*, 88 C.A.2d 708, 200 P.2d 49. This is true though the action is filed in equity. 16 Cal. Jur. 429; *Williams v. Southern Pacific R. Co.*, 150 Cal. 624, 89 Pac. 599; *Bell v. Bank of California*, 153 Cal. 234, 94 Pac. 889.

The petitioners have been guilty of gross laches, barring their claim. *In re Chicago, R. I. & P. Ry. Co.*, 168 F.2d 587, 592, cert. den. 335 U.S. 855; *McColgan v. Maier Brewing Co.*, 134 F.2d 385, 388, cert. den. 320 U.S. 737; *Piedmont Ice & Coal Co. v. American Service Co.*, 130 F.2d 78. In some of these cases the late suitor had not been a party to the reorganization. Here the Corporation was a party, whose general counsel had considered the claim while the reorganization was open and had dismissed it as having no practical value (this brief, p. 17). Meanwhile the world relied upon the consummation of the plan and the finality of the reorganization proceedings.

The petitioners are estopped to present their claim. For upwards of twenty years the holding company settled consolidated return obligations with its subsidiaries by the accepted formula. One who participates in an established course of conduct may not, after the event, attach new consequences to customary activity. See, for example, *Railroad Company v. United States*, 103 U.S. 703, where the railroad

sought a revision of the customary formula for allocating payments for mail carriage; *Stagg v. Insurance Company*, 10 Wall. 589; *County of Los Angeles v. Cline*, 165 Cal. 299, 197 Pac. 67. In each case the claim was denied because it was a departure from the customary practice.

IV. The Amount of the Tax Saving

At the trial expert witnesses for both sides testified and presented exhibits with respect to various methods of computing the amount by which the income taxes of the trustees for the calendar years 1942 and 1943 and the first four months of 1944 were reduced by the returns which were filed. Plaintiff's witness was Robert Buchanan (R. 911-55) who presented three alternative computations in one exhibit (Plaintiff's Exhibit No. 80, R. 919, 1825-9). Defendants' witness was James L. Cockburn, Jr. (R. 1501-85), who presented four alternative computations embodied in Defendants' Exhibits Nos. 41, 43, 44 and 45 (R. 1536, 1541, 1548-9; 2032-9).

Each of these seven computations was based upon different assumptions and arrived at different conclusions as to the amount of the so-called "tax saving" of the trustees during this period. The wide disparity in the views of these expert witnesses, and in the effect of the divergent assumptions adopted by them, is shown by the fact that their computations produced seven different results ranging in amounts from a minimum of $1,034,446 shown by Defendants' Exhibit No. 45 (R. 2038) to a maximum of $17,201,739 indicated by Basis One of Plaintiff's Exhibit No. 80 (R. 1825). The great uncertainty of these computations is

demonstrated even more strikingly by the fact that there was a difference of almost $7,000,000 between the highest (Basis One) and the lowest (Basis Three) of the results obtained by plaintiff's own expert witness (Ex. P. 80, R. 1825, 1829).

While this evidence was being offered the District Court recognized that it was of significance if, but only if, the Corporation should be held entitled to recover (R. 1544). Since the District Court concluded that there should be no recovery, it had no occasion to determine the amount of the tax saving. The opinion of the District Court (R. 257-76) contains no discussion of this subject and no reference to the numerous problems involved in making a computation of the amount of the tax saving. In its recital of the facts of the case, the Court referred to the tax saving in terms of the highest of all of the amounts appearing in the seven alternative computations presented in the exhibits prepared by the expert witnesses, namely, $17,201,739 (R. 262, 264, 267). Similar statements appear in the opinion of the Court of Appeals (R. 2218), which likewise had no occasion to determine the amount of the tax saving. In other words, both courts used this maximum amount as a convenient means of describing the Corporation's claim, without defining it.

Obviously, if either court had decided that the Corporation was entitled to some portion of the tax saving then it would have been necessary to determine the amount of tax which was saved. Such a determination would require that the $4,144,828 tax actually paid by the trustees for this period (R. 266-7) be compared with some imaginary tax which they would have been required to pay under

other circumstances and under different tax returns.[59] This process would require decisions as to what imaginary or hypothetical circumstances should be assumed, what type of returns should be considered as having been filed in lieu of those actually filed, and what answers should be given to the numerous questions involved in the computation of such imaginary taxes. For example, it would be necessary to determine whether the imaginary tax should be computed on a consolidated return basis, with the Corporation's stock loss eliminated as a deduction, or upon a separate return basis. The Corporation's own expert witness presented computations on both bases, differing in result by almost $7,000,000 (R. 1825-9).

This is not the only question involved, however, nor is it the most difficult. If the separate return basis were to be used, it would be necessary to decide what treatment should be given to the operating loss carry-overs and unused excess profits tax credits which the trustees had accumulated in prior years, and what disposition should be made of inter-company interest accruals and other inter-company transactions which were of no consequence in consolidated returns. Separate return computations would also require a consideration of the possible tax effect of the partial worthlessness of a large debt owed to the trustees by one of the operating company's subsidiaries, the Sacramento Northern Railway, which was the subject of testimony of not only Mr. Cockburn (R. 1531) but also Mr.

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[59]Compare Securities and Exchange Commission Release No. 53, Accounting Series, In the Matter of "Charges in Lieu of Taxes," Note 23, "* * * The facts are, of course, that there has not been a static or standard or 'normal' tax law or tax status * * *." Excerpts from Release No. 53 are in Appendix B, at p. 10.

Charles Elsey, the president of the operating company and the agent of the trustees during reorganization (R. 1322). In addition there were problems affecting both separate and consolidated return computations, such as the questions arising out of the large claims of the Government for adjustment of freight charges upon war-time traffic, all of which would affect the gross and net income of the trustees during the war years, including the period in question (R. 1289-1306; 1529-31; 1614-25). Of like character are questions as to the proper treatment of accelerated amortization allowances, a subject upon which there was much confusion during the trial (R. 936-9; 1523-7). Finally, it would be necessary to consider the extent to which the trustees might properly have utilized other tax saving methods which were legally available to them and might have been used if the Corporation's huge loss had not been available (R. 934-5).

Each of these is a most difficult and complex problem which would have to be solved before it would be possible to compute the amount of the imaginary or hypothetical tax which would then have to be compared with the tax actually paid in order to determine the amount of the tax saving. Just one of these items alone, the effect of the treatment of the trustees' operating loss carry-overs and unused excess profits credits, would make a difference of nearly $6,000,000 in the amount of the tax saving, as is readily apparent from a brief comparison of Basis One with Basis Two in Plaintiff's Exhibit No. 80 (R. 1825-29). As Mr. Buchanan, the Corporation's expert witness, himself testified (R. 920-4, 933, 951-3) the only difference between these two computations is that in Basis

One the trustees were deprived of the use of their own carry-overs and credits, whereas in Basis Two the trustees were given the benefit of these items. The resulting difference in the trustees' taxes, according to Mr. Buchanan, is $5,773,937.

These carry-overs and credits were not attributable in any way to the operations, activities or status of the Corporation. They were attributable solely to the operations of the trustees in the years prior to 1942. They had nothing whatever to do with the Corporation's stock loss. Mr. Buchanan testified (R. 922) that the reason for the Basis One computation, depriving the trustees of their own carry-overs and credits, was that the regulations of the Commissioner of Internal Revenue (Regs. 110, Sec. 33.31(e) and (f)) then in effect provided that the carry-overs and credits attributable to the members of an affiliated group during a consolidated return period would all inure to the benefit of the parent upon any change from consolidated to separate return tax reporting.[66] These particular carry-overs and credits were accumulated by the trustees in 1940 and 1941 when consolidated returns were filed, so in computing the imaginary tax of the trustees on a separate return basis for 1942 and later years Mr. Buchanan made his two separate computations, one depriving the trustees of their pre-1942 carry-overs and credits and the other giving them the benefit of them.

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[66]On March 13, 1943, the Commissioner of Internal Revenue repealed this obviously unfair rule and replaced it with the proper rule (applicable, however, to only those carry-overs and credits arising after December 31, 1941) that upon a change to separate returns the carry-overs and credits go with the members who created them (T.D. 5244 and T.D. 5245, 1943 Cum. Bull. 439, 801). The latter rule has prevailed ever since and is presently found in Sections 24.31(d) and (e) of Regulations 129.

This entire sum of $5,773,937 is included in the $17,201,739 "tax saving" figure so often mentioned in the briefs of the petitioners. In other words, more than one-third of the amount by which they claim the income taxes of the trustees were reduced through use of the Corporation's loss had nothing to do with that loss, but is instead the amount by which the taxes of the trustees would have been increased through forfeiture of their own operating loss carry-overs and unused excess profits tax credits if the Corporation had refused to join in consolidated returns after 1941. In seeking to collect this $5,773,937 the petitioners are not seeking to recover a "tax saving" at all. They are trying instead to collect retroactively the amount of additional taxes which the Corporation could have forced the trustees to pay the United States by refusing to continue to file consolidated returns during the period in question. This is a potential "tax loss"—not a tax saving. Yet the $17,201,739 figure so frequently and erroneously described in petitioners' briefs as the saving realized by the trustees through use of the Corporation's loss (e.g., in the "Summary Recapitulation of Basic and Incontrovertible Facts" at page 36 of Petitioner's brief in No. 150) includes this very same $5,773,937 as part of the so-called "tax saving." The fact that it does include this item, which is nothing more than the amount of damage the trustees would have suffered if they had not been able to use their own carry-overs and credits after December 31, 1941, clearly shows the extreme character of the claims of petitioners. It also shows that neither the District Court nor the Court of Appeals could possibly have considered that this amount of $17,201,739 really represented a true measure of the

tax saving attributable to the Corporation's stock loss deduction.

The courts below never considered or decided the questions involved in computing the amount of the tax saving. We respectfully submit that those questions need not be decided even now, because petitioners are not entitled to any portion of the tax saving, whatever its amount may be.

V. The Decisions Below Rest Upon Undisputed Facts and on Identical Grounds. There Has Been No Error in Findings or in the Failure to Make Them and the Court of Appeals Made No Findings.

The petitioners said in their brief in the trial court: "The essential facts are not only relatively few and simple, but they are wholly undisputed. Indeed, there appears to be no conflict whatever in the record, and in major part the facts appear from documentary evidence." (Corp. opening brief, p. 1. Interveners joined in this brief.)

Where the facts are undisputed, findings are unnecessary, *Fontes v. Porter*, 156 F.2d 956; *Douds v. Local 1250, Retail etc. Union*, 170 F.2d 695, 699.

The trial court reviewed the facts in its opinion and adopted its opinion as its findings (R. 319). This was proper, F.R.C.P. 52(a). The Court of Appeals made no findings.

The Corporation now argues that the trial court agreed with a *proposed finding* that there was domination (Corp. brief, pp. 29-31) but the record shows that (1) the proposed finding is not included in the record on appeal (R. 277-9), (2) the Corporation applied for such a finding (R. 465, 469-70), (3) respondents opposed it as contrary to the fact (R. 471-4, 485-6), and (4) the trial court refused it (R. 319).

The trial court held, properly, that "the so-called 'duality

of control' " is immaterial (R. 274).[61] The Court of Appeals agreed (R. 2235). Both courts held that the Corporation could not have lawfully acquired the "tax saving" by agreement (R. 274, 2234).

In their specifications of error on appeal (R. 2168, 2173) the petitioners failed to assign any error respecting findings or the failure to make them. Again it was said (Corp. opening brief (on appeal), pp. 30-31) "while the facts are unusual, they are not in dispute."

The trial court found against the equitable validity of petitioners' claim. The Court of Appeals sustained, saying "we agree with the principal holding of the trial court" (footnote 12, R. 2227). The Court of Appeals disapproved only what it recognized as a "dictum" in the trial court's opinion, pointing out that the trial court had itself recognized that its criticisms of the returns and the settlement were nothing other than "dictum."[62]

The Corporation has no standing to exploit the domination theory in view of its express denials of all the interveners' allegations of domination and control (R. 156).

The trial court observed, and no one disagreed, that "everybody was * * * acting completely in the open in the

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[61] Petitioners by reiteration would create the impression that the trial court found domination, e.g., Corp. brief, pp. 48-9; Int. brief, pp. 38-40. It made no such finding. It said "there is a preponderance of evidence in favor of the plaintiff's contention of 'duality of control' " (R. 272) and that "The so-called 'duality of control,' much discussed and emphasized, is not important in resolving the tendered issue" (R. 274). As noted above, when a finding of domination was applied for it was refused.

[62] The Corporation now says, contrary to what it said in the trial court (R. 466-7), that the trial court denied recovery "because respondent defrauded the government." Corp. brief, p. 47. The trial court explicitly stated the contrary—"I am not passing on whether the Bureau * * * were deceived or misled or not." (R. 467.)

matter, nobody was concealing anything from anyone else, the element of fraud or deception, of the kind you refer to, is absent * * * Everybody knew that consolidated returns were being filed * * * Everybody knew that these attorneys were being employed to file this consolidated return. It was done right out in the open * * * So that the defendant railroad company wouldn't have to pay any income tax * * *" (R. 970, 971).

The Court of Appeals approved (R. 2226):

Where two courts below have made concurrent findings, this Court will not again review the facts. *Comstock v. Group of Institutional Investors*, 335 U.S. 211, 213-4.

The Court of Appeals stated (R. 2235) that "the record is barren of evidence to support the contention that Corporation was dominated by the subsidiary, or that there was a breach of duty owed to the Corporation."

The record, a record of *undisputed facts*, fully supports this statement (this brief, pp. 4-18, 21-3). But the Court of Appeals did not rest its decision on that state of facts. On the contrary, it held:

> "Assuming, as we have, that the subsidiary dominated Corporation through control of the dual officers, * * *" (R. 2232).

nevertheless the Corporation's claim was without merit.

Where the factual basis of the decision is clear, additional findings are unnecessary. *Bowles v. Cudahy*, 154 F.2d 891, 894; R. 2236-7.

Findings on rejected contentions are not required. *Schilling v. Schwitzer-Cummins Co.*, 142 F.2d 82; *Oedekerk v. Muncie Gear Works, Inc.*, 179 F.2d 821, 823.

A Court of Appeals may properly decide a case on grounds on which the trial court made no findings where the record is clear and no genuine issue of fact is presented. *Muncie Gear Co. v. Outboard Co.*, 315 U.S. 759; *Hazeltine Research, Inc. v. General Motors Corp.*, 170 F.2d 6, cert. den. 336 U.S. 938; *Burman v. Lenkin Construction Company*, 149 F.2d 827.

VI. In Disposing of the Petitions for Rehearing the Court of Appeals Has Not Departed from the Accepted and Usual Course of Judicial Proceedings.

The appeal to the Court of Appeals was assigned to and heard by a panel of three judges consisting of one circuit judge and two district judges sitting by special assignment. Petitioners did not object to the composition of the panel and, when the appeal was heard, made no request or suggestion that it should be heard in banc. It is not contended nor could it be contended that there was any error here.

When petitioners' appeal failed they asked for a rehearing and that the rehearing be before the Court of Appeals in banc. In accordance with the established practice of that Court these petitions were referred to the panel that heard the appeal and the petitions for rehearing were denied and, insofar as they sought a rehearing in banc, they were ordered stricken as being without authority in law or in the rules or practice of the Court of Appeals (R. 2259, 2260), Judge Fee dissenting (R. 2261) as he had on the original appeal (R. 2239). Thereafter petitioners petitioned for leave to file "Motion to vacate order striking appellant's petition for rehearing en banc and reinstating such petition" (R. 2267), which petition was considered by

the full court of seven circuit judges and was denied in an opinion by Judge Healy concurred in by five other circuit judges (R. 2288), Chief Judge Denman dissenting (R. 2296).

There is no contention that the panel that heard the appeal could not deny a petition for a rehearing insofar as it was an ordinary petition for rehearing. Petitioners contend, however, that they were entitled *as of right* to have their request for a rehearing in banc considered and acted upon by all seven of the active circuit judges. The question here is not whether a majority of the active circuit judges *may* order a rehearing in banc without the request of a majority of the judges who heard the appeal in division, but whether a losing party may *compel* all of the active judges to entertain and pass upon its petition for a rehearing in banc. Six of the seven active judges of the court below have held that they cannot be compelled to entertain such a petition, their ruling being that whether a rehearing in banc shall be granted is a matter of administrative and intramural concern and that the composition of the court that is to determine an appeal, either on original hearing or on rehearing, is outside the province of the parties. It is submitted that this position is entirely sound.

Petitioners read the opinion of Judge Healy (R. 2288) as holding that a majority of the active circuit judges have no power to order a rehearing in banc unless a majority of the three-judge division which originally heard the appeal approves (Corp. brief, pp. 148-52). This, we submit, is a misconception of what the majority decided.

Under Section 46(c) of Title 28 U.S.C. a majority of the active circuit judges may, in their discretion, order a re-

hearing in banc and this either with or without concurrence of the division that originally heard the appeal.[63] Inasmuch as no such rehearing had been ordered by a majority of the active circuit judges that question was not presented nor

[63] This is clear in view of the history of Section 46. Before the Judicial Code was revised in 1948, Section 117 of that code (then 28 U.S.C. Sec. 212), the predecessor of Section 46, provided that in each circuit there should be a Circuit Court of Appeals consisting of three judges, two of whom would constitute a quorum. This presented a question whether, in a circuit having more than three circuit judges, all of the judges could sit in banc. In *Textile Mills S. Corp. v. Commissioner*, 314 U.S. 326, this Court resolved the conflict on this point between the Third Circuit in the *Textile Mills* case itself, 117 F.2d 62, and the Ninth Circuit in *Lang v. Commissioner*, 97 F.2d 867, holding with the Third Circuit that a circuit court of more than three circuit judges could sit in banc. This was followed in *U. S. ex rel. Robinson v. Johnson*, 316 U.S. 649, where this Court, in remanding the case to the Ninth Circuit for further proceedings because of a conflict between two divisions of the Ninth Circuit and so that consideration could be given to the court's decision in *Waley v. Johnson*, 316 U.S. 101, suggested that leave be granted to petitioner to apply for a hearing in banc.

The Court's interpretation of the former statute was carried into the revision and 28 U.S.C. Sec. 46(c) now provides:

> "(c) Cases and controversies shall be heard and determined by a court or division of not more than three judges, unless a hearing or rehearing before the court in banc is ordered by a majority of the circuit judges of the circuit who are in active service. A court in banc shall consist of all active circuit judges of the circuit."

According to the reviser's note,—

> "This section preserves the interpretation established by the Textile Mills case but provides in subsection (c) that cases shall be heard by a court of not more than three judges unless the court has provided for hearing in banc. This provision continues the tradition of a three-judge appellate court and makes the decision of a division the decision of the court, unless rehearing in banc is ordered."

The point of importance is that while Section 46(c) and the *Textile Mills* case make plain the power of a Court of Appeals to sit in banc, there is nothing in either of them that even suggests that a disappointed litigant has any right to a rehearing in banc or to demand as of right that his petition for a rehearing be passed upon by all of the active circuit judges of the circuit.

was the majority attempting to pass upon that question. The question before the Court of Appeals was, *absent any order by a majority of the circuit judges that there be a rehearing in banc,* what is the established practice of the court relating to petitions for rehearing in banc? Specifically, does a disappointed appellant, who has lost its appeal in division, have the right to compel all of the active circuit judges to entertain and pass upon its petition for rehearing in banc? That, and only that, was what the majority ruled upon, as clearly appears.

After first pointing out that by ordering the case to be heard in division the court has indicated that a hearing in banc on original hearing is not deemed requisite, the majority go on to state the question before them thus:

> "There remains to inquire whether the losing party in the cause is at this juncture *entitled as of right to have the petition for rehearing considered and ruled upon by a court composed of all the circuit judges.*" (R. 2293) (Emphasis supplied.)

That is all that the court was deciding.

On that issue, what does the court say? It is simply this: "* * * the court has consistently retained to itself as a matter of administrative and intramural concern only the problem whether or not any given case should be heard or reheard in banc." (R. 2295) And further: "* * * the composition of the court to which a case may be assigned for determination is a matter wholly outside the province of the parties." (R. 2295)

Not only is this entirely sound, but the reason for it, stated by the court, is equally sound.

> "Adoption of the view currently being urged [by petitioners here] would render merely tentative or pro-

Appendix A

Excerpts From Relevant Statutes

I. Section 141, Internal Revenue Code.[1]

(a) *Privilege to file consolidated income and excess-profits-tax returns.* An affiliated group of corporations shall, subject to the provisions of this section, have the privilege of making consolidated income and excess-profits-tax returns for the taxable year in lieu of separate returns. The making of consolidated returns shall be upon the condition that the affiliated group shall make both a consolidated income-tax return and a consolidated excess-profits-tax return for the taxable year, and that all corporations which at any time during the taxable year have been members of the affiliated group making a consolidated income-tax return consent to all the consolidated income- and excess-profits-tax regulations prescribed under subsection (b) prior to the last day prescribed by law for the filing of such return. The making of a consolidated income-tax return shall be considered as such consent. In the case of a corporation which is a member of the affiliated group for a fractional part of the year, the consolidated returns shall include the income of such corporation for such part of the year as it is a member of the affiliated group. * * *

(b) *Regulations.* The Commissioner, with the approval of the Secretary, shall prescribe such regulations as he may deem necessary in order that the tax liability of any affiliated group of corporations making consolidated income- and excess-profits-tax returns and of each corporation in the group, both during and after the period of affiliation, may be returned, determined, computed, assessed, collected, and adjusted, in such manner as clearly to reflect the income-

(1) 26 U.S.C. Sec. 141.

and excess-profits-tax liability and the various factors necessary for the determination of such liability, and in order to prevent avoidance of such tax liability. * * *

(c) *Computation and payment of tax.* In any case in which consolidated income-tax and excess-profits-tax returns are made or are required to be made, the taxes shall be determined, computed, assessed, collected, and adjusted in accordance with the regulations under subsection (b) prescribed prior to the last day prescribed by law for the filing of such returns; except that the tax imposed under section 15 or section 204 shall be increased by 2 per centum of the consolidated corporation surtax net income of the affiliated group of includible corporations. * * *

(d) *Definition of 'affiliated group'.* As used in this section, an 'affiliated group' means one or more chains of includible corporations connected through stock ownership with a common parent corporation which is an includible corporation if—

(1) Stock possessing at least 95 per centum of the voting power of all classes of stock and at least 95 per centum of each class of the nonvoting stock of each of the includible corporations (except the common parent corporation) is owned directly by one or more of the other includible corporations; and

(2) The common parent corporation owns directly stock possessing at least 95 per centum of the voting power of all classes of stock and at least 95 per centum of each class of the nonvoting stock of at least one of the other includible corporations.

As used in this subsection, the term 'stock' does not include nonvoting stock which is limited and preferred as to dividends. * * *

* * * * *

II. Section 23(g), Internal Revenue Code.[2]

Deductions from gross income. In computing net income there shall be allowed as deductions:

* * * * *

(g)(2) *Securities becoming worthless.* If any securities (as defined in paragraph (3) of this subsection) become worthless during the taxable year and are capital assets, the loss resulting therefrom shall, for the purposes of this chapter, be considered as a loss from the sale or exchange, on the last day of such taxable year, of capital assets.

* * * * *

(4) *Stock in affiliated corporations.* For the purposes of paragraph (2) stock in a corporation affiliated with the taxpayer shall not be deemed a capital asset. For the purposes of this paragraph a corporation shall be deemed to be affiliated with the taxpayer only if:

"(A) At least 95 per centum of each class of its stock is owned directly by the taxpayer; * * *

* * * * *

III. Section 7(b), Bankruptcy Act.[3]

Sec. 7(b) Where the bankrupt is a corporation, its officers, the members of its board of directors or trustees or of other similar controlling bodies, its stockholders or members, or such of them as may be designated by the court, shall perform the duties imposed upon the bankrupt by this Act.

IV. Section 77, Bankruptcy Act.[4]

Sec. 77(a) * * * If the petition is so approved, the court in which such order is entered shall, during the pendency of

(2) 26 U.S.C. Sec. 23(g).

(3) 11 U.S.C. Sec. 25(b).

(4) 11 U.S.C. Sec. 205.

the proceedings under this section and for the purposes thereof, have exclusive jurisdiction of the debtor and its property wherever located, and shall have and may exercise in addition to the powers conferred by this section all the powers, not inconsistent with this section, which a Federal court would have had if it had appointed a receiver in equity of the property of the debtor for any purpose. * * *

Sec. 77(c) * * * Where a trustee is appointed who within one year prior thereto has been an officer, director, or employee of the debtor corporation, any subsidiary corporation, or any holding company connected therewith, the judge, subject to ratification by the Commission as herein provided, shall appoint another trustee or trustees who shall not have had any such affiliations: *Provided,* That the appointment of such additional trustee or trustees shall not be required for a debtor the annual operating revenues of which were less than $1,000,000 for the previous calendar year.

Sec. 77(e) Upon the certification of a plan by the Commission to the court, the court shall give due notice to all parties in interest of the time within which such parties may file with the court their objections to such plan, and such parties shall file, within such time as may be fixed in said notice, detailed and specific objections in writing to the plan and their claims for equitable treatment. The judge shall, after notice in such manner as he may determine to the debtor, its trustee or trustees, stockholders, creditors, and the Commission, hear all parties in interest in support of, and in opposition to, such objections to the plan and such claims for equitable treatment. After such hearing and without any hearing if no objections are filed, the judge shall approve the plan if satisfied that: * * * (3) the plan provides for the payment of all costs of administration and all other allowances made or to be made by the judge, * * *

Sec. 77(f) * * * Upon the termination of the proceedings a final decree shall be entered discharging the trustee or trustees, and making such provisions as may be equitable, by way of injunction or otherwise, and closing the case. * * *

Sec. 77(l) In proceedings under this section and consistent with the provisions thereof, the jurisdiction and powers of the court, the duties of the debtor and the rights and liabilities of creditors, and of all persons with respect to the debtor and its property, shall be the same as if a voluntary petition for adjudication had been filed and a decree of adjudication had been entered on the day when the debtor's petition was filed.

Appendix B

Material Relating to Allocation of Taxes by Corporations Filing Consolidated Returns

I. MATERIAL FROM THE FEDERAL TRADE COMMISSION

A. Report of the Federal Trade Commission on Public Utility Holding Companies.[1]

The Public Utility Holding Company Act of 1935 resulted in part from an investigation of the practices of public utility holding companies by the Federal Trade Commission. The report of the Commission reads, in part, as follows:

Income of holding companies due to methods of handling Federal income-tax payments. — Some holding companies have collected from their respective subsidiary companies funds with which to pay Federal income tax for all the

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(1) Summary Report of the Federal Trade Commission to the Senate of the United States, pursuant to Senate Resolution No. 83, 70th Cong., 1st Sess., on Economic, Financial and Corporate Phases of Holding and Operating Companies of Electric and Gas Utilities, Part 72-A, Sen. Doc. No. 92, 70th Cong., 1st Sess.

companies in a group. The total amount of funds collected by the holding companies from the subsidiaries usually exceeded the amounts actually paid by the holding companies. This practice has resulted in an unusual, if not unjustifiable, means of income to those holding companies engaging in this practice.

During 1923 to 1929, inclusive, The North American Co., from this practice, recorded 1.6 percent of its total income, and Associated Gas & Electric Co. recorded 3.3 percent of its total income. While New England Power Association, in effect, followed this practice, it added the excess amounts so collected to a suspense account and not to income. Cities Service Co. added the amounts collected in following this practice to surplus and related accounts.

Some State commissions engaged in the regulation of gas and electric public-utility companies have permitted operating companies to add the estimated amounts of Federal income tax to operating expenses. These estimated amounts are then, in many cases, paid to a holding company, which, in turn, files a consolidated Federal income-tax return. Any saving in tax accomplished through the consolidated return accrues to the gain of the holding company and is retained.

The fact that holding companies retain the difference between the amounts collected from subsidiaries and the amounts paid as income tax indicates that holding companies have not tried to pass on to their subsidiaries the savings which evolve from the corporate structure of holding-company groups. Instead of subsidiary operating companies having this saving, the operating expenses of those companies are inflated by such amounts. The original amounts charged to subsidiary companies were estimated on a basis of what those companies would have had to pay if individual income-tax returns had been made. Inasmuch as the amounts for Federal income tax should never have

been added to operating expenses in the first place and were only estimated amounts, anyway, and also, since the amounts were in excess of the Federal income-tax requirements of the group, it would seem that due to this practice there is an inaccurate recording of the true cost of operations of the electric and gas operating companies following this procedure.

In order to emphasize the extent of collections of estimated amounts for Federal income-tax payments from subsidiary companies, by certain holding companies, over the amounts of Federal income tax paid by those holding companies, some illustrations are given.

One illustration of this procedure appears in the report on New England Power Association. During 1928 and 1929 the subsidiary companies paid to New England Power Association, on the basis of individual Federal income-tax returns, $376,971.36 in excess of the amount of Federal income tax paid by the holding company on the basis of consolidated income-tax returns.

During the years from 1926 to 1929, inclusive, Associated Gas & Electric Co. recorded a gain, due to this procedure of handling Federal income tax, of $2,938,513.12. It is significant to note that Associated Gas & Electric Co. paid no Federal income tax whatever during the years from 1926 to 1929, inclusive, although, of course, Associated Gas & Electric Co. may be subject to assessments in subsequent years for the said period. Also, New England Gas & Electric Association, affiliated with Associated Gas & Electric Co., recorded during 1927 to 1929, inclusive, as income $514,662.99 on the basis of the plan explained above, but no Federal income tax was paid by New England Gas & Electric Association to the United States Government.

An outstanding illustration of this procedure is shown in the report on Cities Service Co. During the years from 1922 to 1930, inclusive, Cities Service Co. collected from its

subsidiaries $11,611,601.35 for Federal income taxes. During this period, Cities Service Co. paid Federal income taxes on the basis of a consolidated income-tax return in the sum of $1,745,220.98. The excess amount collected over the amount paid by Cities Service Co. was $9,866,380.37.

As a further illustration, The North American Co. recorded as income $324,915.17 in 1927, $675,000 in 1928, and $275,000 in 1929, or a total of $1,274,915.17 in the 3 years, from handling Federal income-tax payments in the manner previously described.

This Commission considers that there should not be added to operating expenses of electric and gas utility companies any amounts paid as Federal income tax. The amounts paid as Federal income tax should be deducted from the net income on which the tax was calculated.

Holding companies are not justified in recording as income the savings from this procedure of handling Federal income-tax payments. The subsidiary companies in a holding-company group are entitled to the benefit of any savings to the group due to filing a consolidated income-tax return. Only the amount of Federal income tax paid by a holding company on the basis of a consolidated return should be borne, in proportion to the taxable income, by those companies having taxable income, for which companies a consolidated return was filed. Stated differently, each company in a holding-company group should pay only its pro-rata share of the tax paid for the group. Then no gain from this source would be derived by holding companies.

The pro-rata amount of the total Federal income tax, paid by an operating subsidiary company, should be properly treated on the books of the operating companies. These amounts are not a part of the costs of producing and distributing electric energy or gas (pp. 477-479).

***The Commission further stated:*[2]**

(2). *Direct Statutory Inhibitions*

The more usual and long-established method of legislation which directly and specifically prohibits certain practices, with proper penalties, cannot be overlooked in discussing remedies for the present utility holding company situation. This means that a separate statute should be drawn which makes felonies or misdemeanors of the disclosed abuses so far as they may be reached under Federal jurisdiction. That is to say, it would apply to all utility corporations or their holding companies and affiliates or subsidiaries which are engaged in interstate commerce or which directly affect such commerce. It is believed such legislation can be made to cover situations where a holding company controls in any degree the acts and policies of corporations in different States although no one of them operates in more than one State. The privilege of the mails may also be denied as to all matter and transactions intended to promote or carry on the enumerated abuses.

The recommendations immediately following relate primarily to protection of the rate-paying public.

* * * 5. A proper amendment to the Federal income-tax law to prevent collection of anticipated income taxes from operating subsidiaries by holding companies and nonpayment to the Government; also to prevent evasion of such taxes through various forms of so-called "reorganizations", carried on largely within the holding company groups and often primarily for the purpose of such avoidance. In a single instance such avoidance involved a cash profit of over $9,000,000 (pp. 69-70).

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(2) Summary Report of the Federal Trade Commission to the Senate of the United States, pursuant to Senate Resolution No. 83, 70th Cong., 1st Sess., on Holding and Operating Companies of Electric and Gas Utilities, Part 73-A, Sen. Doc. No. 92, 70th Cong., 1st Sess.

II. MATERIAL FROM THE SECURITIES AND EXCHANGE COMMISSION

A. Excerpts from Securities and Exchange Commission Release No. 53, Accounting Series:

For Release in MORNING Newspapers
of Friday, November 16, 1945

SECURITIES AND EXCHANGE COMMISSION
Philadelphia

Securities Act of 1933
Release No. 3100

Securities Exchange Act of 1934
Release No. 3750

Public Utility Holding Company Act of 1935
Release No. 6200

Accounting Series
Release No. 53

IN THE MATTER OF "CHARGES IN LIEU OF TAXES"

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VI

THE TREATMENT OF "TAX SAVINGS" IN FINANCIAL STATEMENTS FILED WITH THIS COMMISSION

Cases involving the treatment of so-called "tax savings"[23]

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(23) We think it undesirable in principle and possibly misleading to refer to this problem as involving "tax savings" although due to the general use of the term in this sense we have adopted that nomenclature here. It seems to us that the term "tax saving" is apt to connote some sort of standard or normal tax law and a standard or normal earnings year to which that law applies. The facts are, of course, that there has not been a static or standard or "normal" tax law or tax status; nor has it been possible except in most unusual cases to characterize any particular fiscal year of a company as a "normal earnings" year, from which all others are to be regarded as departures. Under such conditions, each year's tax is whatever happens to result from the application of the computation formula, provided by the tax law of that year, to the sum total of taxable transactions and tax deductions resulting from whatever business may have been done in that particular year. Moreover, the past few years during which the term and the problem of "tax savings" appeared have clearly been unusual in nearly every respect. Finally, if the phenomenon in question is to be described as a "tax saving" it would seem necessary to describe as a "tax loss" the failure to carry through a transaction which it can be said would have resulted in a "tax saving." And if taxes in one year are higher should not that increase itself be considered to be a "tax loss." Our strong preference is to describe the problem as involving "tax reductions."

in financial statements have arisen with increasing frequency in recent months. For that reason, as stated earlier, we feel it desirable to state our views as to the treatment to be accorded such items in statements filed with us and to point out the reasons which have led us to those conclusions.

* * * * * *

We now examine the contention that income taxes should be allocated "as other expenses are allocated." The accountants who appeared before us cited to us no other expense which, for general accounting purposes, is allocated in the manner proposed for income taxes, nor have any such instances otherwise come to our attention. We note, moreover, that in a dissent to the bulletin mentioned earlier it was stated:

> "No expense other than federal income and profits taxes is allocated on the basis of applying to a given transaction so much of the expense as would not have occurred if the transaction to which the expense is attributed had not taken place. The usual method is to allocate a total expense ratably to given accounts or transactions on a consistent basis."

The illustrations of expense allocation cited to us by the certifying accountants in this case appear to us to support the above statement. In each case cited there was an expense actually incurred that was first allocated to the period under the usual accrual principles and then distributed over a number of accounts. In no case was there an estimate made of what the expense would have been under other conditions. In no case cited, was there a distribution of an expense to several accounts by means of what can be termed an algebraic formula in which a negative sum is credited against one item to offset the positive charge to another item of an amount in excess of the actual expense. We do not regard such a treatment as an appropriate means of allocating in-

come taxes in financial statements which purport to reflect the actual results of operations. We have doubt indeed that such a method can properly be termed an allocation at all, as that term is customarily used.

We note, in passing, moreover, that in the examples of expense allocation cited to us there existed a direct, almost physical association between the item being allocated and the item to which it was charged. For example, in the case of real estate taxes allocated to construction the tax item is directly and closely related to the construction. Likewise, in the case of brokerage fees, and stamp or transfer taxes, the tax item is closely and directly related to the specific transaction. *In both cases, moreover, the tax is independent of any other transactions of the company.* Nor is there any attempt made to increase in the course of the allocation the amount of such taxes to an estimated sum. We feel therefore that such illustrations can not properly be cited in support of the proposed treatment for income taxes.

It is also sometimes pointed out that "cost" in the case of securities or property acquired is generally considered to be the sum of the purchase price plus incidental costs such as brokerage and any specific taxes paid by the buyer and that on sale the proceeds are computed as the selling price less incidental deductions such as commissions or any specific taxes paid by the seller. By analogy and in justification of the proposed treatment of income taxes it is frequently urged that a so-called "tax saving" must be allocated or attributed to or ultimately associated with particular losses or expenses because the tax consequences of the transaction involving the loss or expense were a motivating factor in arriving at the decision to consummate it. Thus, it is claimed that a property would not have been sold but for the "tax saving" thereby effected and that for this reason it is proper to consider that the true "loss" on the sale is not the excess of cost over selling price but is equal

instead to the difference between cost on the one hand and selling price *plus* "tax saving" on the other. We do not believe such an analogy is sound and we cannot accept that analysis as a basis for reporting the results of actual operations. It is undoubtedly true that the tax consequences of selling a property often are an important consideration in arriving at the decision to sell, and may in some cases have been a deciding factor. However, tax consequences undoubtedly play an important role in the making of a great variety of decisions involving the incurrence and amounts of purely operating expenses such as advertising, wage rates and bonus plans. Yet it can hardly be argued that wages or bonuses or advertising are to be reported as less in amount because income taxes would have been higher if the amounts spent on such items were less. We see no basis for adopting a different approach in figuring the "loss" involved in a sale of property. We feel instead that there has been a loss of the full difference between cost and selling price coupled with a tax benefit which is properly reflected in the lower taxes actually paid. We feel that the proposed treatment of income taxes tends to obscure these facts and that the treatment of income taxes required by our rules and heretofore almost universally followed clearly discloses what has taken place. Where the tax paid for the year is unusual in amount because of unusual conditions, an appropriate explanation would be called for as is now required in the case of other unusual events.

As to this last principal contention urged by the certifying accountants (that income taxes are an expense that should be allocated as other expenses are allocated) we feel, first, that there is grave doubt whether income taxes can properly be considered as an expense in the same category as the cost of materials or wages, and, second, that the treatment proposed does not result in the allocation of income taxes "as other expenses are allocated." We feel instead that the proposed treatment is purely an effort to have items shown in

the income statement at what is considered to be a "normal" amount. We note that this objective is clearly expressed as a prime purpose of the method in the bulletin referred to earlier which states at p. 185:

> "As a result of such [unusual] transactions the income tax legally payable may not bear a *normal* relationship to the income shown in the income statement and the accounts therefore may not meet a *normal* standard of significance." (Emphasis supplied.)

There are, finally, a number of difficulties involved in the proposed treatment of income taxes that deserve mention even though they are not directly related to the specific contentions put forward by the certifying accountants in the case.

The first involves the preparation of general statistical data from financial reports. Under the method proposed, it is permissible to show, as taxes, an amount in excess of the taxes payable. If such items are totalled for a period of years or for groups of companies, they may well be used as evidence of the aggregate amount of taxes paid by the company or by the industry. Obviously any such representation is erroneous and will misstate, often very materially, the underlying facts. We feel that we should not permit the filing with us of income statements which readily permit, if they do not actually invite, such misuse. Even a "charge in lieu of taxes" may result in distorted overall statistics since it operates to reduce net income after taxes and so affects the ratio of actual taxes to net income. If the offsetting credit is netted against a surplus charge the distortion may be permanent.[35]

(35) Under one variant of the practice no change is made in *final net income*. In the statements originally filed in the instant case, for example, part of the amount included as a charge among the operating expenses represented a \$609,949 reduction in income taxes due to the taking for tax purposes of accelerated amortization of emergency facilities at the rate of 20% a year while in the finan-

The second and somewhat technical problem is the difficulty of the computation. It is usual in contemplating the tax consequences of a proposed transaction to treat it as an incremental or marginal item. Where tax rates are graduated, this results in associating the marginal income or expense with the highest tax bracket. It is questionable, whether such a principle is realistic when applied to the results of operations for a completed year. Net taxable income is a composite of all taxable income and all deductible items applicable to the period. The propriety of singling out any specific item as the item which is taxed in the highest tax bracket, is doubtful. Moreover, in applying the theory to losses and expenses it would appear that the existence of a reduction in taxes is due not only to the expense but is equally dependent on the existence of taxable income to offset the expense. It would appear possible that some part of the benefit from the "reduction" ought to be attributed to the existence of income.[36] Even if this

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cial statements only normal depreciation was being accrued. See p. 11 *supra* and Exhibit A. In the original statements this $609,949 was added back as the last item in the account. This internal in-and-out treatment appears to us to suffer from all of the difficulties we have discussed even though no change results in the amount of "net income." In our opinion, an overstatement of operating expenses is not corrected by "adding back" the amount of the overstatement at a later point in the income statement. Such treatment is in our view artificial and deceptive to all but the most experienced reader. While there may be some grounds for crediting such reductions in taxes to a special amortization reserve there is none for the equivocal practice here followed.

(36) We note the customary solution of a somewhat similar problem that arises when a group of companies files a consolidated tax return. In assigning to each constituent its fair share of the consolidated tax paid by the group it is usual to divide the actual tax among the companies who would have had to pay a tax on an individual basis. If one of the included companies operated at a loss, the consolidated tax is of course reduced, but *no* part of the "saving" is ordinarily paid over to the loss company by the other members of the group. Instead, only those *contributing* income to the consolidated return share directly in the benefit of the current reduction. This principle is incorporated in our Rule U-45 under the Public Utility Holding Company Act.

point be waived, however, there has been no satisfactory analysis presented of the effect to be given to the carry-back, carry-forward provisions of the present income tax law. Without exploring all of the possible difficulties, one case may be cited. Suppose that a loss has been charged to surplus but is deductible for taxes. Suppose further that in accordance with the present proposal there is charged to income, as provision for taxes, the amount of $200,000 although the actual tax amounts to only $50,000. If in the next year the company suffers an operating loss of $500,000, then in view of the carry-back provisions the reader of the two income statements would reasonably expect to find a carry-back refund of $200,000—the amount shown as taxes in the first year. However, obviously no more than $50,000 would actuallly be refundable. The question arises whether having overstated taxes in the first year it is not necessary, to be consistent, to overstate the refund in the second year. Finally, there are the permutations in the computation where a company pays taxes as a member of a consolidated group. In addition to the allocation of the actual tax paid among the several companies in the group, the proposed treatment raises the difficult question of whether the amount of the so-called "saving" is to be computed on the basis of a company's individual status or on that of the consolidated group and, once this is decided, of whether to allocate this "saving" as between the several companies or attribute it solely to the company having the deduction—even though perhaps it itself contributed no taxable income!

The third difficulty is the propriety of singling out the income tax item for adjustment on the ground that it does not bear a "normal" relationship to the income reported. Particularly, under conditions like the present, many if not most of the income and expense items bear unusual relationships to each other. Under the influence of the war sales volumes are often very high. Maintenance may be

very high due to continuous operation of the plant, or very low because of the inability to obtain materials and labor, or very high because of the use of inexperienced labor and the inability to get new machinery, or very low because operations cannot be stopped long enough to make thoroughgoing maintenance possible. Selling costs may be very low because of the volume of war business or very high because of the use of advertising to keep restricted products in the public's mind. With many items of income and expense apt to be out of line, there appears to be little justification and a good deal of danger in singling out one item for adjustment.

III. MATERIAL FROM THE NATIONAL ASSOCIATION OF RAILROAD AND UTILITIES COMMISSIONERS

A. Excerpts from the 1943 Report of the Committee on Accounts and Statistics of the National Association of Railroad and Utilities Commissioners.

The subject of federal income and excess profits taxes has reached an importance in utility regulation requiring our constant consideration.

It has come to our attention that some utilities are including in the expense accounts for taxes, as a part of the accrual for federal income and excess profits taxes, amounts which they do not pay because of advantage gained by them from certain statutory deductions. We wish to call to your attention the fact that only the amount which it is anticipated will actually be payable for federal income and excess profits taxes can be included in the expenses of a public utility under the systems of accounts now in effect. The so-called "provision in lieu of taxes" may not be entered as an expense of the utility, nor may the amount of taxes which would have been payable, had certain statutory deductions not been available, be recorded as the tax expense.

In view of the importance of such taxes, the Committee has endeavored to prepare a report form that will present

to the regulatory commissions such information as it must have for an adequate understanding of the impact of federal income taxes. Our endeavor is to prepare a form that will not involve substantial additional work and still will provide the necessary information. A draft of such form was prepared by the conferee representing the Michigan Commission (Mr. C. R. Angell) and the said draft has been discussed at our meetings. Such discussion has brought out certain difficulties which it is hoped will soon be overcome. After the said report has been prepared to the satisfaction of the Committee, it will be circulated among all of the member commissions for their attention (pp. 255-56).

B. Excerpts from the 1945 Report of the Committee on Accounts and Statistics of the National Association of Railroad and Utilities Commissioners.

Federal Income and Excess Profits Taxes

In the 1943 and 1944 reports of the Committee, attention was directed to the problem of accounting for federal income and excess profits taxes by utility companies. Since the beginning of the period of high wartime taxes it has been the practice of many utilities to include in their tax accounts or in unprescribed accounts, such as "charges in lieu of taxes," amounts which do not represent taxes actually payable. Specifically, these amounts represent reductions in taxes otherwise payable except for extraordinary transactions such as a refunding of bonds, losses on sales of non-operating property, and of statutory provisions permitting amortization for tax purposes over a five-year period of certain facilities which qualify under the tax law as emergency facilities. The whole question, however, is complicated by a multiplicity of circumstances whereby there is non-conformity of taxable net income and financial net income reflected by a utility's books of account.

Extensive study also has been given to this question by the staff of the Securities and Exchange Commission, who

furnished considerable material to aid the Committee in its consideration of the question. At the May, 1945 meeting, the Committee culminated its study of the problem by concurrence in the following points:

(1) Income tax expense accounts should be charged with no more than the actual tax liability or a reasonable estimate thereof.

(2) A caption, "charges in lieu of taxes" or similar title should not be used.

(3) When charges to income measured by tax savings are made, they must be made to the proper account for the item to be charged off and must be adequately described.

(4) In assigning income taxes to departments and non-utility operations and transactions, the distribution should be to those departments, etc., which show net profits or income; it is not permissible to assign negative amounts to departments, etc., which show net losses.

An interpretation in accord with the foregoing is included with this report.

* * * * * * *

The Chairman of your Committee canvassed the views of the members and conferees and submitted the question for further discussion at the meeting in May, 1945. On the basis of this interchange of views, the Chairman was authorized to issue the following statement:

* * * For accounting purposes no charge can be permitted in operating expenses except for expenses actually incurred during the period for which the income statement is prepared. Provisions for future expenditures made during a current period must be made by means of an appropriation of net income.

With respect to the rate-making treatment, the following should be observed:

(a) The inclusion as an operating expense of any portion of tax savings, regardless of how they are described or of what they are to cover, is entirely unwarranted. (pp. 458-460)

IV. MATERIAL FROM THE TREASURY DEPARTMENT

A. I.T. 3637 [1944 Cumulative Bulletin 258]:

Section 29.115-3: Earnings or profits.

INTERNAL REVENUE CODE.

For the purpose of determining the earnings and profits of each member of an affiliated group of corporations for the taxable year 1942 in order to ascertain the amount of earnings and profits of each member of the group which is available for dividends, the consolidated income tax for that year should be apportioned between the members of the group in consonance with the ratio of each corporation's normal-tax net income to the consolidated normal-tax net income, and the consolidated excess profits tax should be apportioned between the members of the group on the basis of the adjusted excess profits net income.

Advice is requested as to the proper method of allocating consolidated income and excess profits taxes for 1942 in the case of an affiliated group of corporations for the purpose of determining the amount of the earnings and profits of each member of the group which is available for dividends.

Authority for the filing of consolidated income and excess profits tax returns for the year 1942 is found in section 141(a) of the Internal Revenue Code, as amended by section 159(a) of the Revenue Act of 1942. Section 141(b) of the Code, as amended, delegates to the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, the right to prescribe such regulations as he may deem necessary "in order that the tax liability of any affil-

iated group of corporations * * * and of each corporation in the group * * * may be returned, determined, computed, assessed, collected, and adjusted, in such manner as clearly to reflect the income- and excess-profits-tax liability * * * and in order to prevent avoidance of such tax liability." In so far as they are pertinent to the present inquiry, Regulations 104, the consolidated income tax regulations, and Regulations 110, the consolidated excess profits tax regulations, are substantially identical.

Section 33.12(a) of Regulations 110 provides that the consolidated return shall be filed by the common parent corporation for the affiliated group. Section 33.12(b) prescribes that each subsidiary must prepare a certain statement consenting to Regulations 110 and authorizing the common parent corporation to make the consolidated return. Section 33.15(a) of Regulations 110 prescribes that "Except as provided in paragraphs (b) [liability of a corporation in bankruptcy or receivership] and (c) [liability of a subsidiary after withdrawal from the group], the common parent corporation and each subsidiary * * * shall be severally liable for the tax * * *." Section 33.16(a) of Regulations 110 reads in part as follows:

> The common parent corporation shall be for all purposes [except where a subsidiary has withdrawn from the group and except where the common parent corporation is dissolved] * * * the sole agent, duly authorized to act in its own name in all matters relating to such tax, for each corporation * * * of the affiliated group. The corporations, other than the common parent, shall not have authority to act for or to represent themselves in any such matter. For example, all correspondence will be carried on directly with the common parent; notices of deficiencies will be mailed only to the common parent * * *; the common parent will file petitions and conduct proceedings before the Board of Tax Appeals [now The Tax Court of the

United States] * * *; the common parent will file claims for refund or credit; refunds will be made directly to and in the name of the common parent * * *; and the common parent in its name will give waivers, give bonds, and execute closing agreements * * * and all other documents, and any waiver or bond so given * * * or any other document so executed, shall be considered as having also been given or executed by each such corporation.

For the year 1941, except in the cases of affiliated railroad corporations and Pan-American trade corporations, consolidated returns were not permitted for Federal income tax purposes, such returns being allowed only in connection with the excess profits tax. With respect to the year 1941, section 23(c)(1)(B) of the Internal Revenue Code, prior to its amendment by section 105(c)(1) of the Revenue Act of 1942, permitted the excess profits tax as a deduction in determining normal-tax net income. In this connection, Treasury Decision 5086 (C.B. 1941-2, 38, at page 46), amending Regulations 103 to conform to the Revenue Act of 1941, added section 19.23(c)-4, relating to deductibility of the excess profits tax imposed by Sub-chapter E of Chapter 2 of the Code. Paragraph (d) of section 19.23(c)-4 of Regulations 103, as so added, provides as follows:

The deduction allowable to a taxpayer which is a member of an affiliated group filing a consolidated excess-profits tax return is an amount which bears the same ratio to the excess-profits tax of the group as the normal-tax net income of the taxpayer, computed without a deduction for excess-profits tax, bears to the sum of the normal-tax net incomes of the several members of the group, computed without a deduction for excess-profits tax.

As shown above, in the case of a consolidated return, each member of the affiliated group is severally liable for both the income tax and the excess profits tax. It has also been shown that all tax matters are handled solely by the common parent corporation. That is for administrative reasons; each legal entity is still preserved. It was stated in Senate Report No. 960, Seventieth Congress, first session (C.B. 1939-1 (Part 2), 409, at pages 418, 419), in connection with the revenue bill of 1928:

> The advisory committee of the Joint Committee on Internal Revenue Taxation, the members of which worked most of the summer in preparing suggestions for the simplification of the revenue laws and their administration, reached the conclusion that, because of the difficulties encountered in administration, there should be a substitute for the consolidated returns provision. It should be emphasized that this conclusion was reached, not upon the ground that consolidated returns were unsound, that additional revenues would be received by the elimination of the consolidated returns provision, but solely upon the ground that the administration of the law would be simplified.
>
> * * * * * * *
>
> The permission to file consolidated returns by affiliated corporations merely recognizes the business entity as distinguished from the legal corporate entity of the business enterprise.
>
> * * * * * * *
>
> * * * The committee believes it to be impracticable to attempt by legislation to prescribe the various detailed and complicated rules necessary to meet the many differing and complicated situations. Accordingly, it has found it necessary to delegate power to the Commissioner to prescribe regulations legislative in character covering them.

The Bureau is not concerned with arrangements made between affiliated companies as to the payment of the tax. The regulations look to payment being made by the parent corporation only, as such corporation is the only member of the group which can transact negotiations with respect to the tax. As a matter of fact, one of the affiliates may make all of the tax payment via the parent corporation, but if there is an overpayment, the refund is made to the parent corporation. (See section 33.16(a), Regulations 110, supra.)

In determining the amount of earnings and profits of each member of the affiliated group which is available for dividend purposes, it is necessary that each company's earnings be separately ascertained. One of the factors in determining earnings and profits for any taxable year is the amount of income and excess profits taxes due for such year. In a consolidated return case, the consolidated taxes should be allocated, as set forth below, to each member of the affiliated group. The fact that the parent corporation pays all of the tax should not militate against such an allocation. As heretofore indicated, such tax is paid by the parent as agent for the subsidiaries.

Accordingly, it is held that for the purpose of determining the earnings and profits of each member of an affiliated group of corporations for the taxable year 1942 in order to ascertain the amount of earnings and profits of each member of the group which is available for dividends, the consolidated income tax for that year should be apportioned between the members of the group in consonance with the ratio of each corporation's normal-tax net income to the consolidated normal-tax net income. The consolidated excess profits tax should be apportioned between the members of the group on the basis of the adjusted excess profits net income.

B. I.T. 3692 [1944 Cumulative Bulletin 261]:

Section 29.115-3; Earnings or profits.

INTERNAL REVENUE CODE.

Method of determining the earnings and profits of each member of an affiliated group of corporations filing consolidated Federal income and excess profits tax returns for 1942 and subsequent taxable years, in order to ascertain the amount of earnings and profits of each member of the group which is available for dividends.

I.T. 3637 (page 258, this Bulletin) amplified.

Request is made for an amplification of I.T. 3637 (page 258, this Bulletin), relating to the method of determining the earnings and profits of each member of an affiliated group of corporations filing consolidated Federal income and excess profits tax returns for the taxable year 1942 in order to ascertain the amount of earnings and profits of each member of the group which is available for dividends

For the purpose of determining the earnings and profits of each member of an affiliated group of corporations for the taxable year 1942 and subsequent years in order to ascertain the amount of earnings and profits of each member of the group which is available for dividends, the consolidated income tax (line 41, page 1, Form 1120) should be apportioned between the members of the group in accordance with the ratio of that portion of the consolidated normal-tax net income attributable to each member of the affiliated group to the consolidated normal-tax net income (line 40, page 1, Form 1120), leaving out of consideration any member of the group having no net income. The consolidated excess profits tax (line 18(c), page 1, Form 1121) should be apportioned between the members of the group in accordance with the ratio of that portion of the consolidated adjusted excess profits net income attributable to each mem-

ber f the affiliated group to the consolidated adjusted excess profits net income (line 8, page 1, Form 1121), leaving out of consideration any member of the group having no net income. The taxes thus determined should be (a) decreased by the amount of the consolidated credit for debt retirement (line 21, page 1, Form 1121) attributable to each company; (b) increased or decreased, as the case may be, by the amount of any section 734 adjustment (line 23, page 1, Form 1121) attributable to each company; and (c) decreased by the amount of the consolidated credit for foreign taxes attributable to each company (line 19, page 1, Form 1121). In the event that the income taxes paid to a foreign country or United States possession are in excess of the amounts allowed as credits, the excess should be taken into consideration in arriving at the earnings available for dividends.

C. I.T. 4085 [1952-1 Cumulative Bulletin 68]:

SECTION 29.115-3; Earnings or profits. 1952-12-13836
(Also Section 141, Section 29.141-1.) I.T. 4085

INTERNAL REVENUE CODE

Method of apportioning the income and excess profits tax of an affiliated group of corporations filing consolidated Federal income and excess profits tax returns for taxable years ending after June 30, 1950, in determining the earnings and profits of each member of such group.

Advice is requested as to the method of apportioning the income and excess profits tax of an affiliated group of corporations filing consolidated Federal income and excess profits tax returns for taxable years ending after June 30, 1950, in determining the earnings and profits of each member of such group.

The excess profits tax for taxable years ending after June 30, 1950, as in the case of normal tax and surtax, is imposed as a part of the income tax on corporations under chapter 1 of the Internal Revenue Code, whereas for taxable years beginning after December 31, 1939, and before January 1, 1946, the excess profits tax was imposed as a separate tax under subchapter E of chapter 2 of the Code. In this regard, section 40.0(b) of Regulations 130 states that the normal tax, surtax, and excess profits tax on corporations are reported on the corporation income tax return, and are treated as one tax for all purposes, including assessment, collection, payment, period of limitations, and the consolidated return privilege.

Notwithstanding the fact that the excess profits tax for taxable years ending after June 30, 1950, is imposed as a part of the income tax under chapter 1 (subchapter D) of the Internal Revenue Code, separate calculations apportioning the income tax and the excess profits tax of an affiliated group of corporations are deemed necessary in computing the earnings and profits of each member of the affiliated group because of (1) adjustments to the consolidated normal-tax net income required in determining the consolidated excess profits net income and (2) allowance of a consolidated excess profits credit in computing the consolidated adjusted excess profits net income.

Accordingly, it is held that in determining the earnings and profits of each member of an affiliated group of corporations filing consolidated Federal income and excess profits tax returns for taxable years ending after June 30, 1950, the consolidated normal tax and surtax imposed under subchapter B of chapter 1 of the Internal Revenue Code should be apportioned among the members of the group in accordance with the ratio of that portion of the consolidated normal-tax net income attributable to each member of the affiliated group to the consolidated normal-tax net income, leaving out of consideration any member of the group

having no net income. The consolidated excess profits tax imposed under subchapter D of chapter 1 of the Code should be apportioned among the members of the group in accordance with the ratio of that portion of the consolidated adjusted excess profits net income attributable to each member of the affiliated group to the consolidated adjusted excess profits net income, leaving out of consideration any member of the group having no net income. The taxes thus determined should be (*a*) increased or decreased, as the case may be, by the amount of any section 452 adjustment attributable to each company, and (*b*) decreased by the amount of the consolidated credit for foreign taxes attributable to each company. In the event that the income taxes paid to a foreign country or United States possession are in excess of the amounts allowed as credits, the excess should be taken into consideration in arriving at the earnings and profits. (For similar method under prior law, see I. T. 3637, C. B. 1944, 258, and I. T. 3692, C. B. 1944, 261.)

D. Excerpts from T.D. 5086, Amendments to Regulations 103 [1941-2 Cumulative Bulletin 46]:

PAR. 21. There is inserted immediately after section 19.23(c)-3 the following:

SEC. 19.23(c)-4. *Excess-profits tax under Subchapter E of Chapter 2 of the Internal Revenue Code.*—The deductibility of the excess-profits tax imposed by Subchapter E of Chapter 2 of the Internal Revenue Code is subject to the following special rules:

* * * * * * *

(d) The deduction allowable to a taxpayer which is a member of an affiliated group filing a consolidated excess-profits tax return is an amount which bears the same ratio to the excess-profits tax of the group as the normal-tax net income of the taxpayer, computed without a deduction for excess-profits tax, bears to the sum

of the normal-tax net incomes of the several members of the group, computed without a deduction for excess-profits tax.

V. TABULATION OF CONGRESSIONAL MATERIAL RELATING TO CONSOLIDATED TAX RETURNS

Senate Finance Committee Reports on the Revenue Bills of 1918, 1921, 1928, 1932 and 1934.

House Ways and Means Committee Reports on the Revenue Bills of 1921, 1928 and 1934.

Memorandum of the Senate Finance Committee on the 1918 Revenue Act.

Report of the Joint Committee on Internal Revenue Taxation (1926).

Hearings before the Senate Finance Committee on the Revenue Act of 1928.

Preliminary Report of Sub-Committee of the House Ways and Means Committee on Prevention of Tax Avoidance (1933).

Hearings before the House Ways and Means Committee on the Revenue Revision of 1934.

Hearings before the Senate Finance Committee on the Revenue Act of 1934.

Joint Hearings of the House Ways and Means Committee and the Senate Finance Committee on Excess Profits Taxation (1940).

Hearings before the Senate Finance Committee on the Revenue Act of 1940.

Hearings before the House Ways and Means Committee on Revenue Revision of 1942.

Appendix C

Petition and Order "In the Matter of Missouri Pacific Railroad Company, Debtor," No. 6935

PETITION NO.

In the

DISTRICT COURT OF THE UNITED STATES
Eastern Division, Eastern Judicial District of Missouri

In the Matter of MISSOURI PACIFIC RAILROAD COMPANY, *Debtor.*	In Proceedings for the Reorganization of a Railroad. No. 6935.

PETITION

Of Trustee Re: 1946 Income Tax Returns for Gulf Coast Lines and International-Great Northern Railroad Company.

Comes now GUY A. THOMPSON, Trustee New Orleans, Texas and Mexico Railway Company, The St. Louis, Brownsville and Mexico Railway Company, The Beaumont, Sour Lake & Western Railway Company, The Orange & Northwestern Railroad Company, New Iberia & Northern Railroad Company, Iberia, St. Mary and Eastern Railroad Company, Houston and Brazos Valley Railway Company, San Antonio, Uvalde & Gulf Railroad Company, Sugar Land Railway Company, Rio Grande City Railway Company, Asherton and Gulf Railway Company, Asphalt Belt Railway Company, San Antonio Southern Railway Company,

Houston North Shore Railway Company, and San Benito and Rio Grande Valley Railway Company, Debtors; hereinafter referred to as the "Gulf Coast Lines," and the International-Great Northern Railroad Company, Debtor, and respectfully states to the Court:

1. That the New Orleans, Texas & Mexico Railway Company, Debtor, is the parent Company of what is known as the "Gulf Coast Lines" and owns all of the stock, except qualifying shares held by Directors, and all of the bonds of each of the Debtor Companies making up the Gulf Coast Lines; that said New Orleans, Texas & Mexico Railway Company also owns all of the stock, except qualifying shares held by Directors and two shares held by other individuals of the International-Great Northern Railroad Company, Debtor.

2. That during the years of these reorganization proceedings, all of the Debtor Companies included in the Gulf Coast Lines and the International-Great Northern Railroad Company, Debtor, have filed their Federal Income Tax Returns on a consolidated returns basis, as it was considered advantageous for them to do so.

3. Trustee further states that a preliminary return on a consolidated basis for the Gulf Coast Lines and International-Great Northern Railroad Company, Debtor, for the taxable year 1946 was filed in March, 1947, said tentative return showing the Income Tax liability of the group for the taxable year 1946 to be $500,720.00; that a detailed and final Return for 1946 must be filed on or before September 15, 1947; that if separate returns are filed, one for the Gulf Coast Lines and one for the International-Great Northern Railroad Company, Debtor, the tax liability of the Gulf Coast Lines will be approximately $2,572,000.00 and there will be no liability for the International-Great Northern Railroad Company, Debtor. On the basis of these estimates, it appears that the filing of a consolidated return, including all of the Debtor Companies named above, will result in

a saving to the following named Gulf Coast Lines Companies of approximately $2,072,000.00, to-wit:

New Orleans, Texas & Mexico Railway Company;

The St. Louis, Brownsville and Mexico Railway Company;

The Beaumont, Sour Lake & Western Railway Company;

Houston and Brazos Valley Railway Company;

Asphalt Belt Railway Company;

Houston North Shore Railway Company.

4. Trustee further states that since in the event separate returns are filed the International-Great Northern Railroad Company would have no tax liability, it is clear that if a final return for the taxable year 1946 is filed on a consolidated basis that the entire tax liability for that year should be allocated to the Gulf Coast Lines Group hereinabove named; that it also appears that International-Great Northern Railroad Company, Debtor, in consideration of its willingness to join the Gulf Coast Lines Companies in making a consolidated return for the taxable year 1946 is entitled to receive from the Gulf Coast Lines Group certain credits or payments; that International-Great Northern Railroad Company, Debtor, sustained a net loss for the year 1946 of approximately $2,690,000.00; that in view of this fact, if a separate return is filed in behalf of the International-Great Northern Railroad Company, Debtor, for the year 1946, it would be entitled to a refund of 1944 taxes resulting from the carry-back of its net loss from 1946 to 1944 amounting to approximately $1,867,000.00.

5. It thus appears that considering the years 1944 and 1946 together, as they must be considered in view of the carryback provisions of the Income and Excess Profits Tax Laws, it is advantageous to the Debtor Companies, as a Group, to file a consolidated return for the year 1946, since the saving of approximately $2,072,000.00 to the above men-

tioned Gulf Coast Lines Companies from such action is in excess of the detriment of $1,867,000 resulting to International-Great Northern Railroad Company from such action. The net saving to the consolidated Group from the filing of a consolidated return for the year 1946 is estimated to be $205,000.00.

WHEREFORE, Trustee Prays:

(a) That his action in filing a preliminary Income Tax Return on a consolidated basis for the Gulf Coast Lines Companies and the International-Great Northern Railroad Company, Debtor, for the taxable year 1946 be approved, and that he be further authorized and directed to file the detailed and final return for 1946 for said Debtor Companies on a consolidated basis.

(b) That immediately upon the filing of said detailed and final return for 1946, the Gulf Coast Lines Debtor Companies that receive a saving in their 1946 income tax return due to the fact that the International-Great Northern Railroad Company, Debtor, has joined with them in said return, shall pay to the International-Great Northern Railroad Company, Debtor, in proportion to their said saving, the amount which the International-Great Northern Railroad Company, Debtor, would have been entitled to receive as a refund to it on 1944 taxes resulting from the carryback of its net loss from 1946 to 1944.

(c) That when the returns of said Gulf Coast Lines Companies and the International-Great Northern Railroad Company, Debtor, have been finally audited by the Internal Revenue Department, that any adjustments which may be appropriate in the light of the figures contained in the returns so finally audited shall be made by the said Debtor Companies.

....

Trustee.

....

Counsel for Trustee.

United States of America
Eastern Judicial District of Missouri
City of St. Louis

Guy A. Thompson, being first duly sworn, deposes and states that he has read the foregoing Petition, and that the facts stated therein are true, as he verily believes.

....

Subscribed and sworn to before me this
21st day of July, 1947.
My Commission expires March 8, 1950.

....
Notary Public.

In the
DISTRICT COURT OF THE UNITED STATES
Eastern Division, Eastern Judicial District of Missouri

In the Matter of
Missouri Pacific Railroad Company,
Debtor.

In Proceedings for the Reorganization of a Railroad.
No. 6935.

ORDER

Re: 1946 Income Tax Returns for Gulf Coast Lines and International-Great Northern Railroad Company.

The Court having considered the Petition of Guy A. Thompson, as Trustee, New Orleans, Texas and Mexico Railway Company, The St. Louis, Brownsville and Mexico Railway Company, The Beaumont, Sour Lake & Western

Railway Company, The Orange & Northwestern Railroad Company, New Iberia & Northern Railroad Company, Iberia, St. Mary and Eastern Railroad Company, Houston and Brazos Valley Railway Company, San Antonio, Uvalde & Gulf Railroad Company, Sugar Land Railway Company, Rio Grande City Railway Company, Asherton and Gulf Railway Company, Asphalt Belt Railway Company, San Antonio Southern Railway Company, Houston North Shore Railway Company, and San Benito and Rio Grande Valley Railway Company, Debtor, hereinafter referred to as the "Gulf Coast Lines," and the International-Great Northern Railroad Company, Debtor, with reference to the 1946 Income Tax Returns for said Gulf Coast Lines and International-Great Northern Railroad Company, Debtor, and having considered the evidence submitted and the arguments of counsel, and it appearing to the Court that during the years of these reorganization proceedings, all of the above named Debtor Companies have filed their Federal Income Tax Returns on a consolidated returns basis and that a tentative or preliminary return on a consolidated basis for the taxable year 1946 was duly filed for said Companies in the month of March, 1947, and it further appearing to the Court that it will be in the interest of said trust estates for Trustee to cause the detailed and final Income Tax Return for said Companies to be filed on a consolidated basis for the taxable year 1946, and that the filing of such a return on a consolidated basis will result in a tax saving to the Gulf Coast Lines of approximately $2,081,000.00, and it further appearing that in the event separate returns are filed for said Companies for the taxable year 1946, International-Great Northern Railroad Company would have no tax liability and would be entitled to a refund of 1944 taxes amounting to approximately $1,861,555.00 resulting from the carryback of its net loss in 1946 to 1944, and it further appearing from Proof of Notice filed herein by Trustee that all parties to the above entitled proceedings have been duly

served with a copy of said Petition, together with notice of the hearing thereon, and the Court being fully advised in the premises:

It Is Ordered:

1. That the action of Debtor Trustee in causing a tentative or preliminary Income Tax Return for the Gulf Coast Lines and the International-Great Northern Railroad Company, Debtor, to be filed on a consolidated basis for the taxable year 1946, be and the same is hereby approved.

2. That said Trustee be and he hereby is further authorized and directed to file the detailed and final return for 1946 for said Debtor Companies on a consolidated basis.

3. That, forthwith, upon the filing of said detailed and final return for the taxable year 1946, such of the Gulf Coast Lines Companies as receive a saving in their 1946 Income Tax by reason of the fact that the International-Great Northern Railroad Company, Debtor, has joined with them in a consolidated return, shall pay to the estate of the International-Great Northern Railroad Company, Debtor, in proportion to their said saving the amount which the estate of said International-Great Northern Railroad Company, Debtor, would have been entitled to receive as a refund to it on 1944 Income Taxes resulting from the carryback of its net loss from the year 1946 to the year 1944.

4. That when the returns of said Gulf Coast Lines Companies and the International-Great Northern Railroad Company, Debtor, have been finally audited by the Internal Revenue Department, that any adjustments which may be appropriate in the light of the figures contained in the returns so finally audited shall be made by the said Debtor Companies.

Geo. H. Moore,
Judge, United States District Court.

Dated: July 29th, 1947.

Filed July 29, 1947. James J. O'Connor, Clerk.

Appendix D

Value of Stock Received by Secured Creditors of the Debtor Under the Reorganization Plan

Under the plan of reorganization, the preferred stock was given an assumed value of $100 per share and the common stock assumed values of $57 and $62 per share. (233 I.C.C. 452)

THE WESTERN PACIFIC RAILROAD COMPANY

Range of Common and Preferred Stock on the New York Stock Exchange

	Common		Preferred	
Year	High	Low	High	Low
*1944	31¾	29¾	66½	65
1945	57⅛	30½	92	64¼
1946	56½	27	101	71
1947	42¼	26½	90	65
1948	36½	25½	74½	58¼
1949	30	20	70¼	53¾
1950	55	28	89	64½
1951	58¾	46½	94¼	84¼
†1952	62	46½	96	89

*From December 29, 1944.
†To November 15, 1952.

Above quotations from THE COMMERCIAL AND FINANCIAL CHRONICLE, WALL STREET JOURNAL *and* STANDARD CORPORATION RECORDS.

IN THE SUPREME COURT OF THE UNITED STA

The Western Pacific Railroad Corporation, et al., Plaintiffs and Petit

v.

The Western Pacific Railroad Company, et al., Defendants and Respor

Metzger, et al., Intervenors and Petitioners,

v.

The Western Pacific Railroad Company, et al., Defendants and Respor

(NOTE: For convenience, the United States District Court for the Northern District of California will be sometimes The Western Pacific Railroad Corporation will be styled the *"Holding Corp,"* and The Western Pacific Railro reorganization will be styled the *"Debtor"* and following reorganization will be styled the *"Reorganized Company."*)

CHRONOLOGY OF REORGANIZATION PROCEEDINGS

CHR

August 2, 1935—
Petition for reorganization pursuant to provisions of Bankruptcy Act filed by Debtor in United States District Court, for the Northern District of California.

September 23, 1935—
Reorganization Trustees appointed by order of Reorganization Court, to be effective as of October 1, 1935, upon ratification thereof by Interstate Commerce Commission.

October 30, 1935—
Order entered by Interstate Commerce Commission ratifying appointment of T. M. Schumacher and Sidney M. Ehrman as Reorganization Trustees.

November 9, 1935—
Order entered by Reorganization Court confirming appointment of T. M. Schumacher and Sidney M. Ehrman as Reorganization Trustees, as appointed by the court and ratified by Interstate Commerce Commission, and directing Trustees to employ Charles Elsey as their Agent.

November 13, 1935—
Surety bonds executed by T. M. Schumacher and Sidney M. Ehrman, as Trustees.

February 8, 1936—
Debtor's plan of reorganization filed.

September 28, 1936—
Institutional Bondholders' plan of reorganization filed.

October 26, 1936—
A. C. James Co. plan of reorganization filed.
(This plan recommended the use of the corporate charter of the Debtor in effecting reorganization.)

T OF THE UNITED STATES

et al., Plaintiffs and Petitioners, } **No. 150**

al., Defendants and Respondents.

and Petitioners, } **No. 160**

al., Defendants and Respondents.

trict of California will be sometimes referred to as the *"Reorganization Court."* *rp,"* and The Western Pacific Railroad Company prior to the consummation of tyled the *"Reorganized Company."*)

CHRONOLOGY OF TAX RETURNS AND RELATED OCCURRENCES

(These Figures in Red)